

***United States Court of Appeals
for the Second Circuit***



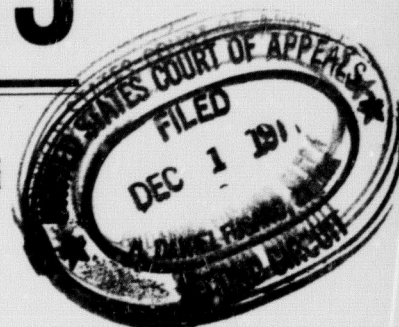
APPENDIX

77-5019

Consolidated Appeals:
77-5019, 77-5022

United States Court of Appeals

For the Second Circuit



In the Matter of

STIRLING HOMEX CORPORATION, *Debtor*

GREGORY JEZARIAN, GERALDINE JEZARIAN, LONETOWN COMPANY, HARRY E. JONES, ALECK GOLDBERG, as Custodian for Mark Goldberg, and MRS. D. WINDSOR DIXON,

Appellants,

FRANK G. RAICHLE, Reorganization Trustee; LINCOLN FIRST BANK OF ROCHESTER; CHEMICAL BANK; THE CHASE MANHATTAN BANK, N.A.; THE FIRST NATIONAL BANK OF CHICAGO; MARINE MIDLAND BANK; and THE TRAVELERS INDEMNITY COMPANY,

Appellees.

**Appeal from the United States District Court
for the Western District of New York**

JOINT APPENDIX

VOLUME II OF TWO VOLUMES — (Pages A266 to A450)

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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

A 266

In the Matter of
STIRLING HOMEX CORPORATION,

In Proceedings for
Reorganization Under
Chapter X of the
Bankruptcy Act

Consolidated Debtor. BK-72-1399

ORDER FINDING DEBTOR INSOLVENT

At Rochester, in said district, on the ^{13th} day of June, 1977.

This cause having come on to be heard before me on the 13th day of June, pursuant to the Order of this Court dated April 28, 1977, and notice of said hearing having been given as required by said Order to creditors and stockholders of said debtor, and other persons designated to receive such notice; and upon said hearing the following have appeared: Frank G. Raichle, Trustee in Reorganization of Stirling Homex Corporation, Consolidated Debtor; Johnson, Reif and Mullan, P.C., attorneys for Trustee, by Byron Johnson, Esq. and Thomas W. Petrillo, Esq.; Zalkin, Rodin & Goodman, attorneys for Chemical Bank, by Henry Lewis Goodman, Esq. and Richard Toder, Esq.; Pomerantz, Levy, Haudek & Block, attorneys for Gregory Jezarian, et al, by Robert B. Block, Esq.; Brown, Kelly, Turner, Hassett & Leach, attorneys for The Travelers Indemnity Company, by Frederick D. Turner, Esq.; Bader and Bader, attorneys for Mrs. D. Windsor Dixon, by I. Walton Bader, Esq.; Nixon, Hargrave, Devans & Doyle, attorneys for Lincoln First Bank of Rochester, by Edward J. Burns, Esq.;

Brown, Wood, Ivey, Mitchell & Petty, attorneys for Merrill, Lynch, Pierce, Fenner & Smith, Incorporated, by A. Robert Pietrzak, Esq.; and Phillips, Lytle, Hitchcock, Blaine & Huber, attorneys for Marine Midland Bank, by Alexander C. Cordes, Esq.

NOW, upon the application of Frank G. Raichle, Trustee, dated April 28, 1977, the Section 167 report of the Trustee dated April 18, 1977, and upon the testimony and evidence developed on the hearing before the Court, no answers having been filed and no objection having been urged by any party in interest, and due deliberation having been had thereon, it is

DETERMINED, FOUND, ORDERED, ADJUDGED AND DECREED, that

1. The fair value of the assets of Stirling Homex Corporation, as consolidated debtor, is \$16,986,376.00.
2. The amount of debts of Stirling Homex Corporation, as consolidated debtor, is \$45,961,000.00.
3. Stirling Homex Corporation, the consolidated debtor, is insolvent and the stockholders have no equity in said consolidated debtor and are not entitled to vote on a plan or share in the distribution of the proceeds of the liquidation of the assets.
4. Stirling Homex Corporation, the consolidated debtor, shall continue in reorganization under Chapter X to enable the Trustee to prepare and submit a plan in the nature of an orderly liquidation of the remaining assets of the consolidated debtor, which plan shall be prepared and presented in accordance with orders of this Court.

5. All other portions of the Trustee's Application, dated April 28, 1977, are reserved for further Order of this Court.

/s/ Harold P. Burke
District Court Judge

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

-----X
In the Matter of

STIRLING HOMEX CORPORATION,

Consolidated Debtor.

In Proceedings for
Reorganization Under
Chapter X of the
Bankruptcy Acts

BK 72-1339
-----X

STATE OF NEW YORK)
: SS.:
COUNTY OF NEW YORK)

ROBERT B. BLOCK, being duly sworn, says:

I am a member of Pomerantz Levy Haudek & Block,
attorneys for Gregory Jezarian, Geraldine Jezarian and Lonetown
Company. I submit this affidavit in their behalf and in behalf
of Harry E. Jones and Aleck Goldberg, as custodian for Mark
Goldberg, in order to present certain evidential matters referred
to in our accompanying memorandum.

A.

Regarding the merits of the claims
against Stirling Homex of the de-
frauded security holders, the
Trustee's knowledge thereof, and
the time required to prove such
claims.

I incorporate herein, as if physically attached as
exhibits:

Transcripts of testimony taken by Trustee Raichle
pursuant to § 167 of the Bankruptcy Act as follows:

<u>Witness</u>	<u>Date</u>
David Stirling, Jr.	October 2, 1972
David Stirling, Jr.	October 3, 1972
Harold M. Yanowitch	October 3, 1972
Harold M. Yanowitch	October 4, 1972

<u>Witness</u>	<u>Date</u>
William G. Stirling	October 4, 1972
Edwin J. Schulz	October 19, 1972
Terrance J. DeHond	October 19, 1972
Jerome Dienstag	October 20, 1972
Reuben Davis	October 20, 1972
Jerome Dienstag	November 2, 1972
William Gary Rumely, Jr.	November 2, 1972*

Annexed hereto as Exhibit 1 is Securities and Exchange Commission Litigation Release No. 6960 dated July 2, 1975, concerning the action arising out of a private investigation conducted by the Commission, brought by it against Stirling Homex Corporation and others in the District Court for the District of Columbia.

Annexed hereto as Exhibit 2 is an extract from Accounting Series Release # 173 dated July 2, 1975 of the Securities and Exchange Commission, titled In the Matter of Peat, Marwick, Mitchell & Co., as reprinted in CCH Fed. Sec. L. Rep. ¶ 72,195. The extract consists of pages 62,475 to 62,491.

Annexed hereto as Exhibits 3 and 4 are copies of the indictment and bill of particulars thereof in the criminal action titled United States of America v. David Stirling, Jr., et al., in the United States District Court, Southern District of New York, 76 Crim. 0685. [The five defendants in that action, all of them former officers of Stirling Homex, were convicted on January 29, 1977 following a jury trial and verdicts of guilty on all counts. Judgment was entered on March 11, 1977, all the defendants are appealing and none of the appeals has as yet been heard.]

The foregoing material shows the indubitable merit of the defrauded security holders' claims as well as their relative simplicity and ready provability.

To establish claims against Stirling Homex (as distinguished from claims against its auditors and other third

* I am advised by the Trustee that all the transcripts referred to have been or shortly will be filed with the Clerk of the Court.

parties in the Jezarian class action), it will be sufficient to prove the falsity of the Company's accounting and of its financial statements, the cost of the claimants' shares and their value at the time of purchase.

The falsity of the accounting is acknowledged by the Trustee at page 4 of his § 167 Report, Exhibit 1 at the June 13 hearing. The cost of the shares is ordinarily established by the broker's confirmation. Their value at the time of suit will be easily shown to have been zero, inasmuch as the bulk of the Company's recorded sales and income were fictitious. See Exhibit 1 hereto, p. 2; Exhibit 2 hereto, especially at pp. 62,482, 62485.

With regard to the Trustee's knowledge of the existence of claims against Stirling Homex of defrauded security holders at and about the time of the bar order herein, December 11, 1972, and the service thereof, I cite, in addition to the above listed transcripts of testimony taken by Mr. Raichle:

Original complaint in Jezarian v. Csapo, U.S.D.C., S.D.N.Y., 72 Civ. 1671 (DBB), served on Stirling Homex on May 1, 1972, annexed hereto as Exhibit 5.

Class claim by Harry E. Jones and Aleck Goldberg, as custodian for Mark Goldberg, filed herein on January 14, 1972, which I incorporate herein by reference as if attached as an exhibit.

B.

Regarding the banks' involvement with the debtor prior to the \$20 million preferred stock offering and their knowledge of the debtor's operations and affairs.

Annexed hereto as Exhibit 6 is Stirling Homex' prospectus, dated July 29, 1971, covering an offering of 500,000 shares of its convertible preferred stock.

Annexed hereto as Exhibit 7 are ¶¶ 17, 18 extracted from an affidavit of Richard S. Simons, a member of the New York law firm of Cravath, Swaine & Moore, sworn to March 29, 1976, submitted by Chemical Bank in opposition to the Jezarian plaintiffs' motion to add the Bank as a party defendant in the Jezarian class action.

Annexed hereto as Exhibit 8 is a copy of a memorandum dated May 21, 1971 of P. Prima of Chemical Bank addressed to M. Ivanetic and others of Chemical Bank, which is part of Jezarian plaintiffs' deposition exhibit 286.

Annexed hereto as Exhibit 9 is a memorandum dated October 13, 1971 from P. Prima of Chemical Bank to M. Ivanetic and W. R. Hazen of Chemical Bank, which has been marked Jezarian plaintiffs' deposition exhibit 291.

Annexed hereto as Exhibit 10 is a copy of a letter dated April 3, 1972 from Chemical Bank to Paul Kuveke, which has been marked Jezarian plaintiffs' deposition Exhibit 294.

Exhibit 6, p. 3, last ¶, shows that at or about the time of the preferred stock offering the banks had already lent over \$37 million to Stirling Homex. The same Exhibit, at p. 9, last ¶, shows that, at the time of the prospectus, negotiations were in progress to restructure that indebtedness under a revolving credit agreement to a maximum of \$55 million.

Paragraph 18 of Exhibit 7 shows that Chemical Bank unqualifiedly assured Merrill Lynch, as lead underwriter for the preferred stock offering, that the Bank would continue to extend credit to Stirling Homex.

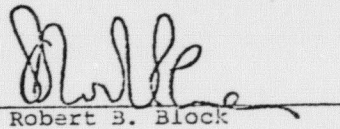
Exhibits 8 and 9 exemplify the information regarding Stirling Homex' day-to-day operations and prospects which the banks routinely acquired during the pertinent period.

Exhibit 10 shows that Chemical Bank acted as agent for the entire group of bank creditors.

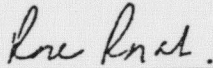
C.

Regarding Mr. Bader's claim that
his client bought preferred stock
directly from Stirling Homex.

The preferred stock prospectus, Exhibit 6, cover page
and pages 22-5, shows that the entire preferred stock issue was
sold by Stirling Homex to the underwriters. No one but the
underwriters, it appears, bought preferred stock from Stirling
Homex.


Robert B. Block

Sworn to before me this
29th day of June, 1977



Rose Rosati

ROSE ROSATI
NOTARY PUBLIC, STATE OF NEW YORK
No. 31-8333730
Qualified in New York County
Commission Expires March 29, 1978

A 274

EXHIBIT 1

**Securities and Exchange Commission Litigation
Release No. 6960 Dated July 2, 1975**

(Reproduced herein as pages A275 to A279)

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

Litigation Release No. 6960
July 2, 1975

SECURITIES AND EXCHANGE COMMISSION v. STIRLING HOMEX CORPORATION
et al. (United States District Court for the District of
Columbia)

The Securities and Exchange Commission ("Commission") announced today the filing of a civil injunctive action in the U.S. District Court for the District of Columbia, the issuance of two opinions pursuant to Rule 2(e) of the Commission's Rules of Practice, and a Report of Investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934, all arising out of the Commission's private investigation in the matter of Stirling Homex Corporation.

In addition, the Commission instituted administrative proceedings against a registered broker-dealer who is also a defendant in the Commission's injunctive action, in connection with certain other matters discussed below.

I The Complaint

The Commission today filed a civil injunctive action in United States District Court for the District of Columbia against Stirling Homex Corporation ("Stirling Homex"), David Stirling, Jr. ("David Stirling"), former Chairman of the Board of Directors of Stirling Homex, William G. Stirling ("William Stirling"), former President of Stirling Homex, Harold M. Yanowitch ("Yanowitch"), former Director, General Counsel and Executive Vice-President of Stirling Homex, Edwin J. Schulz ("Schulz") former Controller and Vice-President of Stirling Homex, Charles W. Marshall ("Marshall") former Director of Stirling Homex, and President of U.S. Shelter Corporation, a Stirling Homex subsidiary, Frank Csapo ("Csapo") former Vice-President of Stirling Homex and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), a New York broker-dealer and Stirling Homex's former investment banker.

The Commission's Complaint alleged that Stirling Homex, David Stirling, Jr. William Stirling, Yanowitch, Schulz, Csapo and Marshall, directly and indirectly, violated and aided and abetted violations of the anti-fraud provisions of the federal securities laws. The Commission's Complaint also alleged that Stirling Homex, David Stirling, Jr., William Stirling, Yanowitch, Schulz and Marshall violated and aided and abetted violations of the periodic reporting provisions of the federal securities laws.

Stirling Homex was engaged in the business of manufacturing and installing multi-family modular units ready for occupancy and during the periods in question, Stirling Homex sold these units under several government housing programs. Stirling Homex went public in early 1970 and in order to show increasing sales, improperly recorded or fabricated nearly all of its reported sales for the periods in question. Due to the tremendous outlay of corporate expenses there was a constant drain on the cash position of the company and in order to continue its operations, the company had a second offering in July, 1971 of \$20 million of convertible preferred stock. In March, 1972, Stirling Homex reported a loss for the six month period ended January, 1972 due in large part to its earlier improper recordation of sales with respect to many of its projects. Thereafter, sales previously booked did not materialize, production was curtailed and debts spiraled. Finally in July, 1972 Stirling Homex filed a petition for reorganization under Chapter 10 of the Bankruptcy Act.

In particular, the Complaint alleges that from 1970 through 1972 the financial statements of Stirling Homex were materially falsified by the fraudulent recording and reporting of fabricated or fictitious sales and the application of inappropriate accounting principles. For example, all module sales of approximately \$12,500,000 included in the February 28, 1971 financial statements contained in the 1971 Registration Statement of Stirling Homex, were either fictitious or improperly recorded including approximately \$8,000,000 of sales from a proposed \$15 million project in Mississippi with the Greater Gulf Coast Housing Corporation. As part of this fraudulent course of conduct designed to deceive the public materially false and misleading registration statements in 1970 and 1971 were filed with the Commission and disseminated to the public by Stirling Homex. Materially false and misleading press releases and letters to the shareholders were issued and materially false and misleading annual and periodic reports were filed with the Commission.

In addition, it was alleged that as apart of the fraudulent scheme in which some of the Defendants participated, illegal political contributions were made, illegal electronic surveillance equipment was used, and corporate funds were used for the personal benefit of some of the management of Stirling Homex. Moreover, certain critical documents were allegedly created, pay-offs to Union officials were made and certain of the Defendants made sales of securities of Stirling Homex while in the possession of material adverse non-public information.

Simultaneously with the filing of the Complaint, David Stirling, William Stirling, Yanowitch, Schulz, Marshall and Csapo, without admitting or denying the allegations in the Complaint, consented to the entry of Judgments of Permanent Injunction enjoining them from violations of the reporting and anti-fraud provisions of the federal securities laws with respect to the securities of Stirling Homex or any other issuer. In addition to the injunction the Court ordered David Stirling, William Stirling, and Yanowitch not to be associated with any corporation whose securities are publicly held without prior Commission approval and to forebear from receiving any assets, properties, or monies of Stirling Homex in any distribution.

which they would be entitled to participate in as a security holder or creditor of Stirling Homex. Further, the Court ordered Schulz not to be associated with any corporation whose securities are publicly owned as a chief financial officer for two years without prior Commission approval. Additionally, Yanowitch, as part of his consent, undertook not to practice before the Commission as defined by Rule 2(e) of the Commission's Rules of Practice without prior approval of the Commission.

The Commission's Complaint with respect to Merrill Lynch alleges it was involved directly and indirectly in the filing with the Commission and the dissemination to the public of the 1971 registration statement of Stirling Homex referred to above and in this regard it is alleged that Merrill Lynch knew or should have known of material facts which were not disclosed in the registration statement and that the inquiry made by Merrill Lynch with respect to the registration statement under the circumstances was inadequate. The Commission's Complaint also contains allegations with respect to violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in the dissemination by Merrill Lynch to its customers of inaccurate or misleading research reports, wire flashes and opinions, earnings and price predictions and statements concerning Stirling Homex and its securities.

Simultaneously with the filing of the Commission's Complaint Merrill Lynch without admitting or denying the allegations in the Complaint consented to the entry of a Judgment of Permanent Injunction enjoining Merrill Lynch from violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with transactions in the securities of Stirling Homex. Further, Merrill Lynch was ordered to adopt within 60 days, implement and maintain policies and procedures relating to its underwriting, research and retailing activities which are reasonably calculated to prevent the recurrence of the matters alleged in the Commission's Complaint.

Finally, with respect to the Commission's request for ancillary relief in the form of disgorgement, with respect to Merrill Lynch the Court entered an Order whereby it would retain jurisdiction over this matter. At such time as there is a final disposition of the last of the civil actions now pending with respect to the securities of Stirling Homex, in which Merrill Lynch is a Defendant, the Commission may apply to the Court for a determination of the profits earned by Merrill Lynch as a result of the activities complained of in the Commission's Complaint. Thereafter, upon a determination by the Court of such profits, Merrill Lynch shall disgorge such profits pursuant to an Order and Plan to be determined by this Court plus interest thereon at 6% per annum from the date of entry of said Order and Plan, provided however, that the Court limit the amount of such disgorgement or not require any disgorgement, based on a consideration of the findings in such civil actions with respect to the matters complained of in Commission's Complaint, including actions wherein determinations favorable to Merrill Lynch have been rendered, and after giving effect to all settlements and money judgments which may have been entered and satisfied by Merrill Lynch.

In connection with the settlement of the Stirling Homex matter, the Commission also today announced the institution of an administrative proceeding against Merrill Lynch and the issuance of Findings, Opinion, and an Order. The administrative proceeding was ordered based on information obtained by the Commission staff concerning transactions by a registered representative of Merrill Lynch in a customer's account in short, intermediate and long term government securities, including Government National Mortgage Association when issued commitments which raised questions concerning the suitability of the transactions and whether they were properly recorded on Merrill Lynch's books and records and another instance involving the use of certain selling procedures by some branch offices of Merrill Lynch in connection with securities which were being offered by a company under the sponsorship of an affiliate of Merrill Lynch.

As part of the settlement of the administrative proceedings Merrill Lynch without admitting or denying the findings in the order, consented to the findings and issuance of an order by the Commission. In determining to accept its offer of settlement and imposing no formal sanction the Commission noted that Merrill Lynch has undertaken to adopt certain policies and procedures to prevent the recurrence of the conduct described in the Commission's order, the fact that Merrill Lynch has reached settlement with the customer involved in the government securities matter, and took into consideration Merrill Lynch's consent to the entry of a Judgment of Permanent Injunction in connection with the Stirling Homex matter pursuant to which it is required to adopt certain policies and procedures.

II Rule 2(e) Proceedings

A. Peat, Marwick, Mitchell & Company

The Commission also announced today that a settlement has been reached with Peat, Marwick, Mitchell & Company disposing of, among other things, an administrative proceeding growing in part out of the Commission's investigation of Stirling Homex. See Litigation Release No. 6961, dated July 2, 1975 and Accounting Series Release No. 173, dated July 2, 1975 for further details.

B. Harris, Kerr, Forster & Company

The Commission simultaneously instituted administrative proceedings against Harris, Kerr, Forster & Company ("HKF"), a partnership engaged in the practice of accounting and issued an Order and Opinion which addresses certain audit questions involving HKF's 1970 audit of Stirling Homex. HKF has submitted an offer of settlement for the purpose of disposing of issues raised under the proceeding without admitting or denying the allegations in the Opinion. See Accounting Series Release No. 174, dated July 2, 1975 for further details.

III. Report of Investigation In the Matter of
Stirling Homex Corporation Relating to
Activities of the Board of Directors of
Stirling Homex Corporation.

The Commission also announced today the issuance pursuant to Section 21(a) of the Exchange Act, of a Report of Investigation relating to activities of the Board of Directors of Stirling Homex Corporation ("Report") which deals in particular with the role of Stirling Homex's two outside directors, Theodore W. Kheel ("Kheel") and John W. Castellucci ("Castellucci"). The Report outlines the background of Stirling Homex, details the composition and functions of its Board of Directors and comments on the role of Kheel and Castellucci as outside directors.

In the Report the Commission did not attempt to set forth general rules or guidelines with respect to the duties of outside directors. Although it noted in this case that Kheel and Castellucci were victims of a fraud perpetrated by Stirling Homex's management and others, which included the withholding of relevant information thereby created difficulties for them in their role as outside directors, the Commission concluded that they "...did not provide the shareholders with any significant protection in fact, nor did their presence on the Board have the impact upon the company's operations which shareholders and others might reasonably have expected." For further details, see Securities Exchange Act of 1934 Release No.11516, dated July 2, 1975.

A 280

EXHIBIT 2

**Extract from Accounting Series Release #173 Dated
July 2, 1975 of the Securities and Exchange
Commission, pp. 62,475 to 62,491**

(Reproduced herein as pages A281 to A297)

STIRLING HOMEX

Stirling Homex Corporation ("Stirling Homex") was engaged in the business of manufacturing and selling completely installed modular dwelling units, ready for occupancy. The concept employed by Stirling Homex was hailed as revolutionary in that the corporation attempted to integrate the many phases of home construction on a fixed site. The modular units were manufactured at a plant, shipped to a site and thereafter assembled into multi-family dwelling units.

Initially, Stirling Homex operated on a relatively limited scale. During the Company's first full year of operations, the fiscal year ended July 31, 1969, approximately 61% of its revenues²² were derived from sales to entities controlled by the principal stockholders of the Company. For the succeeding two fiscal years nearly all revenue was derived from sales to local housing authorities and other non-profit entities who depended on Federal Government funding to finance the purchase of Stirling Homex dwelling units.

Stirling Homex became a public corporation on February 19, 1970 through a public

offering of 1,175,000 shares of common stock at \$16.50 a share. On July 29, 1971 the Company made another public offering of 500,000 shares of cumulative preferred stock at \$40 per share. In July 1972, the Company filed a petition under Chapter X of the Bankruptcy Act. Thereafter the Commission began an investigation of the affairs of the Company.

Information obtained by the Commission in that investigation into the affairs and financial reporting of Stirling Homex for the period 1970 to 1972, indicates to us that a registration statement and certain reports issued by Stirling Homex and filed with the Commission included audited financial statements for the seven-month period ended February 28, 1971 and for the fiscal year ended July 31, 1971 which were false and misleading and did not present fairly the consolidated financial position and results of operation of the Company in conformity with generally accepted accounting principles.

The consolidated statements of income of Stirling Homex for the seven month period ended February 28, 1971 included in the registration statement for the preferred stock⁶³ and the consolidated statements of income of Stirling Homex for the year ended July 31, 1971 contained in the Annual Report to Shareholders and Annual Report on Form 10-K for such fiscal year were false and misleading in that among other things:

—all modular sales of \$12,493,000 for the February 28, 1971 period and \$25,292,600 out of total modular sales of \$29,482,271 for the July 31, 1971 period were improperly recorded in that the purported sales were not supported by required financing commitments;

—installation sales were overstated by approximately \$3,723,000 out of a total reported installation sales of \$5,137,000 for the February 28, 1971 period and \$2,443,000 out of total installation sales of \$7,200,000 for the July 31, 1971 period through the inclusion of sales from projects for which there were no commitments of financing and through Stirling Homex's improper reporting of approximately \$1,000,000 as of February 28, 1971 and approximately \$2,000,000 as of July 31, 1971 of excess installation costs as

⁶³ Also included in the registration statement were unaudited financial statements for the nine month period ended April 30, 1971. Such unaudited financial statements were false and misleading in that all modular sales of \$18,183,000 for the April 30, 1971, period and approximately \$4,656,000 out of the total instal-

"cost overruns" reimbursable to the Company;" and

—general administrative and other expenses were materially understated by approximately \$832,000 as of February 28, 1971 and approximately \$1,000,000 as of July 31, 1971, as a result of the improper capitalizing of such expenses. Additionally, certain other expenses and construction costs were improperly capitalized.

PMM examined and issued unqualified reports on these financial statements. Although it should be noted that it appears that officers and other representatives of Stirling Homex, as well as others, intentionally deceived PMM by misrepresentation and concealment of material information and even the creation of a forged or spurious document, our investigation causes us to believe that PMM's examinations were not conducted in accordance with generally accepted auditing standards and we believe, as is detailed within, that the accounting methods followed by Stirling Homex were not in accordance with generally accepted accounting principles.

Stirling Homex accounted for its sales by separating the manufacturing and installation functions and by recording sales and income on the manufacturing aspect of the transaction upon the supposed assignment of manufactured units to the requirements of a particular housing agency customer. This was supported by a commitment of funding which was supposedly evidenced by receipt of a letter of designation, feasibility letter or other similar document from the local agency. Stirling Homex treated the letters or other documents from the local agencies as the equivalent of a financing commitment, and PMM accepted this concept.

In determining whether there existed a commitment of Federal financing, PMM relied on representations of Stirling Homex management, the Company's supposed experts on government housing programs, an opinion of outside counsel furnished by management, apparent concurrence of other reputable organizations dealing with the Company, and the belief that local housing authorities would not enter into contracts for projects without reasonable assurance that funding would be available. In fact,

installation sales of \$6,382,000 for such period were improperly recorded.

⁶⁴ Had Stirling Homex not improperly capitalized these costs overruns from the installation portion of certain of its projects, it would have incurred substantial losses on completion of these projects.

as we think PMM should have understood, in almost all cases the letters or other documents were not a commitment for Federal financing and without Federal financing the revenue from the project was not assured.⁴³ The acceptance of these representations without further auditing work, particularly in the light of PMM's lack of experience in this area, resulted in improper recognition of sales revenues.

In summary, the Commission believes that the registration statement, reports and the financial statements contained therein portrayed Stirling Homex as a healthy, prosperous company with increasing sales and earnings when, in fact, that company was experiencing serious business problems and financial difficulties. Moreover, nearly all of Stirling Homex's sales and resulting accounts receivable were either improperly recorded or fictitious, and the Consolidated Balance Sheet included in the Annual Reports materially overstated assets by approximately \$36,400,000 as a result of the inclusion in accounts receivable of sales from projects improperly recorded in the current and prior fiscal years.

Stirling Homex Revenue Recognition Policies

Stirling Homex contracted with its customers, primarily public housing authorities, to manufacture and install modular housing units resulting in a housing-development ready for occupancy. Modules were manufactured on an assembly line at Stirling Homex's manufacturing facility in Avon, New York. The modules were later to be shipped to a construction site where they would be assembled into two, three and four bedroom apartments. The apartments, in turn, would be assembled into larger structures consisting of two to five apartment, depending upon the requirements of an individualized site plan. The completed modules contained wall and floor coverings, drapery fixtures and all other necessary appurtenances in order to make the multi-module dwelling unit ready for occupancy when assembled.

The Company purported to follow a revenue recognition policy whereby revenue would be recognized on the sale of each module when manufacture of the module was completed and other events had occurred (including an irrevocable assignment of the modules to a specific contract and a firm commitment of funding for the proj-

ect) which reasonably assured the ultimate collectibility of the sales price. For purposes of revenue recognition, Stirling Homex made an allocation of the contract price as between module manufacture and module installation segments and, upon the manufacture and assignment of modules to a contract, the Company normally recorded as modular manufacture sales approximately 55% of such total contract price. The accounts receivable resulting from the recording of sales upon completion of the manufacture of modules were carried on the books of Stirling Homex as unbilled (not invoiced to customers) receivables. The portion of the total contract price allocated by the Company to module installation was recognized on the percentage of completion basis as site preparation and installation work was performed.

During the period relevant here, Stirling Homex's customers consisted primarily of public housing authorities who looked to Federal government housing programs as sources of financing for their proposed projects. The programs involved were low rent housing programs under the turnkey program of the Department of Housing and Urban Development ("HUD") and a subsidized housing program under Section 236 of the National Housing Act administered by the Federal Housing Administration ("FHA"). In addition, Stirling Homex had one project under the rural housing program of the Farmers Home Administration ("Farmers Home") of the Department of Agriculture.

Most of Stirling Homex's projects in the period under consideration were under the HUD turnkey program. The initial step in this program, following the receipt of proposals including proposed prices from a number of applicants, was the issuance by a local housing authority ("LHA") of a letter of designation, designating an applicant, such as Stirling Homex, as the developer of a specified project subject to specified conditions. Subsequently, if the specified conditions were met, the letter of designation would be followed by a contract of sale between the LHA and the developer, countersigned by HUD to evidence its commitment to finance the project. Until HUD countersigned the contract of sale, there was no legally binding commitment of governmental funds by HUD. Stir-

⁴³ Some projects went forward to completion. Others, and they were larger, did not. The lack of completion resulted from a number of factors, including neighborhood opposition to

housing at particular sites and the inability of Stirling Homex to continue to obtain financing which led to its ultimate collapse.

ling Homex, however, began to manufacture modules and recognize income with respect thereto prior to the countersigning of the contract of sale by HUD and in most cases recognized income upon receipt of a letter of designation.

Commencing in the last quarter of the 1971 fiscal year, Stirling Homex recognized revenues on modules manufactured in connection with three projects which were intended to be financed under the Section 236 program of the FHA. The initial step in this program was the issuance by the FHA of letters of feasibility. These letters, although indicating the FHA's determination that the project was economically feasible and evidencing an intent to participate in the projects upon the satisfaction of certain conditions, did not in fact represent a legally binding funding commitment.⁶⁶ Stirling Homex, however, began to manufacture modules and recognized income when a letter of feasibility was received.

The third governmental program involved was the rural housing program of Farmers Home Administration, a branch of the Department of Agriculture. The one project purportedly financed under this program was the Greater Gulf Coast Housing Development Corp. project in Mississippi which is discussed below. Since the only purported commitment on the part of Farmers Home was a forged or spurious document committing \$15 million, it is unnecessary to discuss the normal operation of this program.⁶⁷

While reviewing Stirling Homex's 1971 registration statement, the staff of the Com-

mission's Division of Corporation Finance questioned the reasonableness of recognizing sales revenues in advance of the date on which the Company was able to validly invoice a customer.⁶⁸ The staff requested that Stirling Homex revise its financial statements to defer recognition of income to that point at which the amount recorded was validly billable to a customer.⁶⁹ Had Stirling Homex complied with this request, its financial statements would have shown substantial losses from operations.

Instead, Stirling Homex requested a meeting with the Division of Corporation Finance to discuss its accounting practices. During this meeting,⁷⁰ and in a written statement submitted shortly after the meeting, Stirling Homex set forth its rationale for the allocation of the total contract price between the module manufacturing phase and the installation phase and represented that no sales were recognized with respect to module manufacturing unless the following five conditions were met:

"(1) The Company must be designated by the LHA non-profit sponsor or other agencies as the contractor for the project. This designation is supported by a formal commitment from the customer to the Company.

(2) The customer must have obtained and submitted evidence to the Company that a commitment of monies to fund the project has been obtained from the appropriate governmental agency under which the project has sponsorship.⁷¹

(3) The numbers and types of modules and the general site plan and improvements must be identified and be the sub-

million. This increase of unbilled receivables created a distorted balance sheet since the current assets were composed primarily of these unbilled receivables.

⁶⁸ The relevant paragraph from the June 30, 1971 letter of comment reads as follows: "It is noted that the number of modules installed through April 30, 1971 is far less than the number manufactured through the fiscal year ended July 31, 1970. It appears to the Division that the registrant's accounting practices recognize income too far in advance of the date of billing to customers. It is requested that the financial statements for the current year be revised to defer recognition of income at least to a point no sooner than the amount is validly billable to the customer."

⁶⁹ At this meeting, which is discussed *infra*, a PMM partner responsible for the Stirling Homex account made a number of statements regarding Stirling Homex's accounting practices which we believe to have been in error.

⁷¹ In its submission, Stirling Homex falsely represented to the staff—as it had to PMM—that a letter of designation from an LHA under the turnkey program represented such a commitment.

⁶⁶ In addition to representations by Stirling Homex that the feasibility letters were a commitment of financing, PMM relied upon an opinion of counsel experienced in FHA matters, furnished to them by Stirling Homex management, which stated that, "In the trade and within the FHA organization, the feasibility letter is considered a binding, firm and reliable document" and "In summary, it is our opinion that the feasibility letter may reasonably be treated for accounting purposes as a basis for recognition of projected projects." The auditors did not fully relate the existing facts to this opinion.

⁶⁷ The materiality of this one project to the financial statements of Stirling Homex is vividly illustrated by the fact that sales on this project represented in excess of 60% of all module sales for the seven month period reflected in Stirling Homex's 1971 registration statement.

⁶⁸ Stirling Homex's unbilled receivables grew rapidly. On December 31, 1969, unbilled receivables were \$644,918. At the end of the 1970 fiscal year, unbilled receivables increased more than seven-fold to \$4.6 million. By July 31, 1971, the unbilled receivables were to increase by over \$25 million bringing the total to \$29.5

ject of the agreement between the Company and its customers.

(4) The Company must assign the manufactured module to a specific project and physically identify the module as being assigned to and reserved exclusively for the specific project and customer. (This identification was to be physically attached at the earliest stage of the manufacture of the module.)

(5) The module must be completed and be ready for shipment to the customer."

In short, it was represented to the Commission by Stirling Homex that before income was recognized in connection with module manufacture all events had occurred which reasonably assured the ultimate collectibility of the sales price properly allocable to such manufacture.

This representation was false and the Commission has concluded that with respect to virtually every project as to which the Company recognized income at the point of module manufacture, one or more of the five conditions stated above had not in fact been satisfied at the time of income recognition.

General site plans were rarely in existence at the time sales and income were recognized from the manufacture of the modules. Because irrevocable assignment of modules to a particular project was, in many instances, largely impossible until such site plans were developed, the purported assignment of modules to projects indicated in the computer runs and other records of the Company shown to PMM, was essentially a sham. In fact, the modules were maintained for the most part on an unsegregated basis and shifted and reassigned from project to project where the need arose.⁷²

More importantly, in virtually every instance there did not exist a firm and legally binding commitment of Federal funds to finance the project. The non-profit entities (some of which were "shells") and the LHA's doing business with Stirling Homex did not have substantial funds of their

own. The letter of designation and feasibility letters did not represent legally binding commitments of funds to purchase the projects and were subject to a number of stated conditions, such as selection and approval of a site, satisfaction of various zoning and building code requirements and agreement on an ultimate contract price. In almost all cases there was no commitment of funding to finance the projects at the time income was recognized.

In contrast to its representations to PMM and the staff of the Commission, that these conditions would routinely be satisfied, the Company, in practice, experienced great difficulties in finding acceptable sites (because of local opposition to the projects and other political and social problems) and in obtaining the zoning and building code variances necessary for its projects. In some instances it also had difficulties in reaching agreement on the ultimate contract price.

Moreover, the Commission believes that the allocation of the contract price as between module manufacture and installation was arbitrary and did not accurately reflect either the relative costs of each segment of the total sales price nor the relative profitability of the two segments. In fact, the actual costs of installation in most of the projects completed by the Company substantially exceeded those portions of the applicable total contract prices that Stirling Homex allocated to the installation work—at least, when there is taken into consideration the cost overruns improperly classified by the Company as accounts receivable.

Stirling Homex's accounting policy with respect to the recognition of sales and income upon completion of the manufacture of modules, which permitted the Company to front-end and prematurely report sales and earnings, was not in accordance with generally accepted accounting principles.⁷³ Following the manufacture of a modular housing unit for sale to an LHA, Stirling

⁷² For example, on the RIT project, which Stirling Homex included in sales for the nine months period ended April 30, 1971, Stirling Homex "assigned" modules to the project for the purpose of recognizing income but they were not the type called for by the project. It was not until May, 1971 that the Company began manufacturing the appropriate modules.

⁷³ In 1970, the Accounting Principles Board issued APB Statement No. 4 which stated the general view on income recognition as follows:

"Revenue is conventionally recognized at a specific point in the earning process of a

business enterprise, usually when assets are sold or services are rendered. This conventional recognition is the basis of the pervasive measure of principle known as realization."

"Revenue is generally recognized when both the following conditions are met: (1) the earnings process is complete or virtually complete, and (2) an exchange has taken place."

While there are some exceptions to this rule, the necessary criteria for such exceptions did not exist in this case.

Homex still owned the modules and bore the risk of a loss.

The Commission believes that the percentage of completion method of income recognition was inappropriate with respect to the installation portion of the projects⁷⁴ since, among other things, the total time required for manufacture of the modules, preparation of the site and installation of the modules did not require more than a few months—assuming site selection, funding approvals and other local approvals were in fact in hand—and, therefore, the contracts probably could not be properly considered as long term contracts.

Retention of PMM

Stirling Homex began to search for a new accounting firm in January of 1971 after encountering resistance to certain of its accounting practices on the part of Harris Kerr Forster and Company ("HKF"), its auditors for the fiscal year ended July 31, 1970.* Stirling Homex apparently contacted a number of accounting firms, including members of the so-called "big eight." In late February of 1971, PMM was retained by Stirling Homex.

PMM was not aware of the approaches by the Company to other accounting firms or of the disagreements between HKF and the Company.⁷⁵ PMM was informed that the principal reason for the change in auditors was purportedly the Company's desire and that of its investment banker to obtain a "big eight" firm. PMM also asked HKF if there were any professional reason why PMM should not accept the engagement. In addition, PMM made inquiries concerning Stirling Homex and learned that the Company had reputable outside directors, legal counsel and bankers.

PMM was retained to perform an audit of Stirling Homex's financial statements for the seven months of the Stirling Homex fiscal year ended February 28, 1971. PMM was informed that such financial statements were to be included in the registration statement to be filed by Stirling Homex with the Commission. The account was assigned to a partner in PMM's Newark, New Jersey office. The audit work, however, for the Stirling Homex account was

to be performed by the PMM staff located in Rochester, New York, working under the direction of a PMM partner in that office.

PMM assigned an SEC reviewing partner from the New York office to the Stirling Homex audit who participated in several meetings where significant decisions were made concerning unresolved audit questions. However, the SEC reviewing partner was unfamiliar with the income recognition policies of Stirling Homex and the government housing programs being utilized by customers of Stirling Homex. He did not review the audit workpapers and, in connection with the February 28, 1971 audit, met only once with the other PMM auditors for face-to-face discussion of the audit.

The Financial Statements of Stirling Homex Reported on by PMM

There is set forth below analyses of specific aspects of PMM's audit of the Consolidated Financial Statements for the seven month period ended February 28, 1971 and for the twelve month period ended July 31, 1971. In the view of the Commission, these analyses demonstrate that in a number of respects PMM's conduct of the audits was not in accordance with generally accepted auditing standards.

In a number of important areas, PMM unduly relied on the representations and interpretations of Stirling Homex management, and on management-prepared schedules and workpapers. It appears that this reliance was due in part to the inexperience of the PMM personnel and their unfamiliarity with government housing programs, government contracting or construction companies. Many such management representations were intentionally false and misleading and constituted part of a deliberate effort by management of the Company to deceive PMM, among others, as to the true status of a number of significant affairs. However, in the Commission's view, PMM accepted uncritically the representations of Stirling Homex with respect to these matters and did not take those steps which were required under the circumstances in order to verify the accuracy of the Company's assertions.

⁷⁴ This method, as indicated above, differed from the method Stirling Homex utilized in connection with recording sales on the manufacture of the modules whereby Stirling Homex recorded sales and income upon the completion of the manufacture of the modules. See Accounting Research Bulletin No. 45.

* See Accounting Series Release No. 174 issued today by the Commission with respect to the activities of HKF.

⁷⁵ Although PMM reviewed HKF work papers, they did not learn of questions raised by HKF regarding the income recognition policies of Stirling Homex which HKF had reported on in the prior years' financial statements.

Thus, PMM's personnel relied on management's representation that a letter of designation represented a firm commitment of financing for a HUD key project. As discussed above, designation did not constitute a commitment of government financing and had not been relied on for that purpose by PMM. Documentation evidencing a legally binding commitment of governmental financing rarely existed prior to the reporting of income by Stirling Homex.

In several instances Stirling Homex obtained from the LHA contracts of sale on which the required HUD signature evidencing that funds had been authorized and reserved for the purchase of the development was missing. Absent such signature, there was no assurance that the project was eligible for financial assistance, that the funds had been properly authorized or that funds had been reserved by the government and were available to effect payment and performance by the purchaser LHA.⁷⁰ Despite the fact that these documents should have been recognized as being incomplete, PMM's personnel relied on the oral representations of Stirling Homex management that in practical effect financing had been committed to these projects. In the Commission's view this reliance was improper.

Similarly, PMM's personnel relied on the representations of management and an opinion of outside counsel expert in FHA matters furnished by management that letters of feasibility in practice represented financing commitments by the FHA. Although a feasibility letter was an important first step in obtaining FHA financing and indicated a strong interest in the project, feasibility letters in general, and the feasibility letters involved here in particular, were subject to specified conditions and, in the Commission's view, they did not represent a binding commitment of funds for the project for income recognition purposes.

The obtaining of a commitment of funding was an especially serious matter since the LHAs and other non-profit entities doing business with Stirling Homex were without financial resources and any agreements they entered into with Stirling Homex required financial backing of the Federal government. However, the audi-

tors did not adequately familiarize themselves with the governmental housing programs despite their lack of prior experience with these programs and did not contact any Federal agency in order to verify the existence of commitments to finance the housing projects involved. The auditors' assumption that the LHAs would not enter into agreements with Stirling Homex without reasonable assurance of government financing was, in the Commission's view, unwarranted.

PMM's personnel relied on management-prepared schedules and workpapers, including computer runs of module assignment to projects, without adequate independent verification of their accuracy. As it turned out such schedules were essentially meaningless unless a final site plan for the project existed. Such a site plan did not exist in many cases. They did not perform the extended audit steps which the Commission believes were called for with respect to the accounts receivable resulting from the improper and premature recording of module sales from periods preceding its engagement by Stirling Homex, carried on the books of Stirling Homex as unbilled accounts receivable.

In the Commission's opinion, the confirmation procedure used by PMM with respect to unbilled receivables was inadequate. The confirmations which were sent to the LHAs sought, for the most part only confirmation of the existence of a letter of designation or contract and the basic terms of the agreement, i.e., the number of housing units and price. In the Commission's view, information, on the status of the project should also have been sought from the LHAs and, although it was perhaps reasonable to assume that an LHA would not confirm a project unless governmental funding was in fact available, the confirmations should have specifically requested confirmation of a funding commitment.

The Commission also believes that the handling of the confirmations by the audit staff was faulty in that they failed to take extended audit steps to evaluate the significance of remarks written on certain of the confirmations or deviations from normal confirmation practices, such as, in one case, the return of a confirmation to the company rather than to the auditors.

⁷⁰ In some cases, Stirling Homex did not actually have a letter of designation but only a preliminary, non-binding letter of intent.

February 28, 1971 Audit

Listed below is a schedule of projects for which Stirling Homex, in the Commission's view, improperly recorded sales during the seven months ended February 28, 1971.

	Module Sales	Percent Total Sales
Portland Project	\$ 569,200	4.5
Rochester	1,200,400	9.5
Ithaca	721,600	5.7
Washington, D. C.	678,400	5.4
Mississippi GGC	7,916,000	62.8
Additional sales recognized on projects previously recorded in the 1970 fiscal year	1,522,400	12.1
	<u>\$12,608,000</u>	<u>100.0</u>

(a) Mississippi GGC Project

This project accounted for 62.8% of the module revenue reported for the seven month period ended February 28, 1971 and represented over 44% of the total revenue reported for the period.

In December, 1970, Stirling Homex entered into a contract (subsequently amended) with the Mississippi Greater Gulf Coast Housing Development Corp. ("GGC"),⁷⁷ a non-profit corporation with no financial substance, for the construction of 800 modular units for \$15,000,000 with the funding to be provided by the Farmers Home Administration, an agency of the Department of Agriculture ("Farmers Home").

As evidence of the financing commitment necessary for the inclusion of sales and earnings from this project in the financial statements, PMM's personnel relied on a letter to GGC from Farmers Home dated February 22, 1971 which purported to represent a commitment of government finan-

cing for \$15 million.⁷⁸ This letter was a forged or spurious document on the stationery of Farmers Home.⁷⁹ GGC had neither a history of operations, nor any financial substance. Since there was no funding for the project, it should not have been included in sales.

The contract with GGC was subject to agreement on acceptable sites for the projects conditioned upon the approval of the appropriate governmental funding agency and the obtaining of financing from the appropriate governmental funding agency. No site plans or proposed site plans existed. No modules were ever shipped to Mississippi for this project, and the project was never built.

Because of the magnitude and effect on the Stirling Homex financial statements of the sales and earnings of this project, it should have been audited with greater care than PMM exercised.⁸⁰ PMM's personnel, without knowing even the general guidelines of the Farmers Home program, accepted their reading of the February 22, 1971 letter and the oral representations of Stirling Homex management at a meeting described below as a sufficient basis to conclude that there was a firm commitment of financing for this project.

On March 19, 1971, three PMM auditors, including the client partner and the SEC reviewing partner, visited the offices of Stirling Homex to discuss with Stirling Homex management problem areas of the audit then being conducted. Among the areas discussed was the absence of evidence of such financing.⁸¹

At this meeting the management of the Company submitted the \$15 million commitment letter for the inspection of the PMM auditors. These auditors requested a copy of the letter for their files, but the

⁷⁷ Although PMM was not aware of this fact, this group was formed at the behest of Stirling Homex solely because of the necessity to have such a corporate vehicle to ostensibly negotiate and contract with Federal agencies for the funding of housing projects.

⁷⁸ The limit of funding on any individual Farmers Home project is restricted by statute to \$750,000. The Mississippi GGC contract provided that Mississippi GGC had the rights to assign its rights under the contract to one or more nonprofit corporations subject to the approvals of the appropriate governmental funding agency involved.

⁷⁹ PMM did not know that the document was forged or spurious and it was presented to PMM as representing a commitment of funding by Farmers Home.

⁸⁰ The confirmation received by the auditors as of February 28, 1971 in connection with GGC confirmed "a contract dated February 28, 1971 providing for total development and construction cost of fifteen million dollars," whereas in fact the contract for which confirmation was being sought was dated December 28, 1970. Although this was treated as a clerical error (and the July 31, 1971 confirmation subsequently received referred to the appropriate contract date) and we do not suggest that this contract was not in fact validly executed, we nevertheless believe that under the circumstances further inquiry should have been made concerning the date of the contract.

⁸¹ PMM's workpapers contain a notation by a PMM partner stating that absent such financing "the income recognition on the sale of the financed modules could be jeopardized."

management of the Company stated they could not provide one at that time, stating that there were "political reasons" for keeping the letter confidential until local announcements were made by the sponsor of the project. No copy of the letter was subsequently obtained, nor did the auditors make an abstract of its terms or attempt to verify the authenticity of the document through direct communication with the Farmers Home. There was no other documentary support in PMM's work papers demonstrating a firm commitment of financing necessary to justify recording the Mississippi GGC project in sales.

Under the GGC contract the non-profit group was responsible for obtaining 100% financing provision was later modified and financing provisions was later modified and U. S. Shelter ("USS"), a wholly owned subsidiary of Stirling Homex, was to arrange financing and receive a 2% financing fee (\$300,000) upon acceptance of this provision by the GGC.

The financing fee of \$300,000 was reflected in the Consolidated Statement of Income contained in Stirling's Homex's 1971 registration statement. The footnotes to the financial statements disclose that this fee was earned under an agreement with a non-affiliated customer whereby USS had rendered certain services to the customer which included the obtaining of a commitment from a Federal agency for permanent financing of a housing project. This income was improperly recognized. This footnote is false and misleading in that although this agreement, as shown to PMM, was dated February 15, 1971, it was in fact signed in March—after the balance sheet date—and thus the non-affiliated customer had not retained USS's services as of the balance sheet date and as indicated above, USS had not obtained any commitment of permanent financing from a Federal agency nor rendered any other services to this customer.

Although PMM mailed a confirmation to GGC concerning this USS financing fee, the confirmation was not returned. PMM did receive, however, a letter from the GGC, but that such fee was subject to cerposed financing commitment to GGC on February 15, 1971 had been accepted by GGC but that such fee was subject to certain terms and conditions of the agreement dated February 15, 1971 and that payment of the fee was to be deferred until the date of any loan closings. The letter did

not state when the proposed financing agreement had been accepted by GGC.

The auditors had a copy of the February 15, 1971 agreement in their workpapers. They questioned the recognition of income by USS of this fee since there was no indication that USS had obtained any commitment for financing. To provide evidential matter to support this financing fee, PMM obtained from Stirling Homex a copy of an ambiguous letter from Stirling Homex's bank which, stated that the bank had approved an unsecured \$15 million line of credit, but also stated that borrowing under the line was to be limited to \$3 million outstanding at any one time. Despite the obvious ambiguity in the letter, the auditors did not confirm the commitment's existence or its terms with the bank.

(b) *Rochester, New York Project*

In late 1970, Stirling Homex submitted a proposal to the Rochester Housing Authority ("RHA") to develop a turnkey project of 91 units on four scattered sites for approximately \$2.3 million. No contract or agreement was executed for this project. Stirling Homex recorded \$1.2 million in modular sales on this project on the basis of a letter of designation from the RHA dated February 26, 1971. These sales constituted a material portion of total sales for the seven month period.

PMM sent a letter to the RHA requesting confirmation that RHA had accepted Stirling Homex's proposal for the 91 units. The letter was returned to PMM marked correct with an attached copy of the letter of designation for 91 units that the RHA had sent to the Company.

The designation letter, while tentatively designating Stirling Homex as developer of the project, set forth a schedule of events and approvals including site approval by various authorities, negotiation of the ultimate price that would have to be effectuated prior to the execution of a firm contract of sale, and a commitment of Federal assistance in financing the purchase of the projects by the RHA. PMM also obtained from Stirling Homex a copy of a letter dated February 26, 1971 to the RHA from the Area Director of HUD which authorized the RHA to designate Stirling Homex as the turnkey developer of the project, subject to the RHA's letter of designation containing the phrase "subject to site approval by the City of Rochester."

The auditors established no procedures to monitor the accomplishment of the events outlined in the designation letter. The various problems of rezoning, adequate sewage systems, and local governmental approvals were never resolved. The proposed Rochester sites were found unacceptable by HUD and the project was never constructed.

There was no legally binding contract in effect between the RHA and HUD or other evidence of financial commitment for this project. Therefore, sales and income in this project should not have been recognized.

(c) Washington, D.C. Project

A proposal was made to the National Capital Housing Authority ("NCHA") in the fall of 1970, to develop this turnkey project which would consist of 51 dwelling units for a proposed purchase price of \$1,217,640. No contract was obtained by Stirling Homex on this project at any time. For the seven month period ended February 28, 1971 Stirling Homex recorded modular sales of \$678,400 for the project.

PMM workpapers contain only three documents to support recognition of \$678,400 of module revenues on this project. One document was a copy of an undated letter proposing two possible housing developments to the NCHA. Another was a letter dated February 26, 1971 from the NCHA to Stirling Homex informing the Company that it had been selected as the turnkey developer for a particular site and additionally informing the Company that approval by the community as well as by the Board of Directors of the District of Columbia Redevelopment Land Agency ("RLA") was required for the development.

The third letter from the RLA, also dated February 26, 1971, indicated that the RLA approved the selection of Stirling Homex as the developer of the site but that final approval could only be given after public hearings before the RLA's Board of Directors. No audit procedures were undertaken by the staff of PMM to determine whether the required approval was ever obtained for this development.

A letter, dated March 12, 1971, was sent to the NCHA by PMM requesting that they confirm the acceptance of the Com-

pany's proposal for a 51 dwelling unit housing development. This letter was returned to PMM signed by an official of the NCHA indicating the information was essentially correct. A typewritten note on the returned NCHA confirmation informed PMM that: "Before the proposal is finalized the Authority, RLA and the HUD Regional Office must review and approve construction and financial details."²²

The Commission believes that, in the circumstances, there did not exist evidence of a commitment by NCHA to purchase the housing units, or a commitment by HUD to finance the project and this income should not have been recognized.

(d) Portland, Maine Project

At the time of income recognition, there was no firm commitment of funding for this project although a subsequent commitment was later obtained in July of 1971 and the project was completed. PMM received from Stirling Homex a copy of a turnkey agreement dated January 28, 1971 entered into by Stirling Homex and the Portland Housing Authority ("PHA") for the sale of a 50 dwelling unit housing development for \$1,280,662. Stirling Homex included in sales \$569,200 from this project. There was no funding for this project identified in the space provided in the contract. Further, the agreement was not signed by HUD. Consequently, there was no evidence of a legally binding commitment of federal monies to fund the purchase of the project at the time of the completion of the audit field work.

As late as June 25, 1971 Stirling Homex, PHA and HUD were still negotiating over price and specifications for the project, and it was not until July 22, 1971 that a firm contract was executed by the PHA, HUD and Stirling Homex.

(e) Ithaca, New York Project

PMM obtained from the Company as evidence that a contract of sale existed a document dated March 3, 1971 by which the Ithaca Housing Authority ("IHA") contracted to purchase from Stirling Homex a completed housing development consisting of 54 dwelling units for \$1,233,050. Although the development was to be purchased and funded under the turnkey program of HUD, no turnkey contract in the required HUD form was executed. There was no formal commitment of Federal

²² In connection with the July 1971 audit, the confirmation return did not contain any such typewritten note.

funding as of the February 28, 1971 period although a formal commitment was subsequently obtained and the project was completed. Sales of \$721,600 from this project were included—improperly in the Commission's view—for the February 28, 1971 period.

(f) *Accounts Receivable at February 28, 1971*

In addition to the newly recognized sales during the period under audit, Stirling Homex carried a substantial amount of accounts receivable and cost overruns on projects recorded as sales during the 1970 fiscal year, which were also audited by PMM during its audit of the seven-month period. Listed below are some of the projects and the amounts of the accounts receivable which the Commission believes were improperly recorded as of February 28, 1971:

Project	Accounts Receivable
Hillwood, Akron	\$4,470,000**
Highland, Akron	3,352,020
Bridgeport Street, Worcester	329,500
Providence Road, Worcester	416,100
Bird and Pearl, Erie	1,283,000
Pittsburgh, Erie	444,400
Grandview, Erie	1,174,600
North St. - Worcester	469,000

All the above accounts receivable recorded on Stirling Homex's financial statements as of February 28, 1971 were recorded, although in several instances in substantially smaller amounts, during the 1970 fiscal year of Stirling Homex ended July 31, 1970. The delays in payments and progress on these projects had continued as of February 28, 1971 and should have prompted extended audit procedures.

With certain exceptions, these projects were in essentially the same posture as they were in the prior fiscal year in that there had been little installation work accomplished, no money collected and no formal commitment of funds by any government agency. The terms of some of the agreements themselves, had expired, such as the 120 day completion clause. All of these projects were HUD turnkey projects. The supporting agreements were not exe-

** Stirling Homex recorded accounts receivable of \$6,818,000 during this period on this project against which \$2,318,000 was purportedly received by the Company, leaving a net receivable of \$4,470,000. In fact the \$2,348,000 which related to three other Akron projects was erroneously applied to this receivable and the figure should have been \$6,818,000.

cuted by HUD and therefore not backed by a funding commitment.

During the audit, PMM's personnel learned that the proposed site for the Bridgeport project had to be abandoned. They received the following statement on a returned confirmation from the Worcester Housing Authority that referred to Stirling Homex's dealings with them on the Bridgeport project:

"In July 1970 this Authority and Kabeth Properties, Inc. were in the process of negotiating a contract for the purchase of 25 units to be erected on Bridgeport Street in Worcester, Massachusetts for the sum of approximately \$563,350.00. Because of problems involving site location, the proposed site had to be abandoned. At the present time, the Authority is awaiting submission by Kabath Properties, Inc. of a set of contract documents for approximately the same number of units on a suitable site in Worcester, Massachusetts.

July 31, 1971 Audit

Listed below is a schedule of projects for which the Commission believes Stirling Homex improperly recorded sales during the fiscal year ended July 31, 1971:

	Module Sales	Percent Total Sales
Rochester	\$1,200,400	4.1
Washington, D. C.	678,400	2.3
Mississippi GGC	8,520,400	28.9
St. Thomas, V. I.	1,360,000	4.6
St. Croix, V. I.	1,360,000	4.6
Clay	1,951,000	6.6
Morgantown	2,418,000	8.2
Stanley Simon	6,282,500	21.3
Grandview	317,600	1.1
Hillwood	86,800	0.3
Highland	1,118,000	3.8
	\$25,292,600	85.8
Total Sales	\$29,482,271	

(a) *Virgin Islands Project*

The documentation in PMM's workpapers for the two projects was identical and the contracting entity was the same, Quantum Development Corporation ("Quantum"), a non-profit corporation sponsoring the

** The Providence Road, Bird & Pearl Street and North Street projects representing approximately \$2,170,000 out of a total account receivable figure at February 28, 1971 of \$26,960,000 were paid for prior to July 31, 1971. However, cost overruns on the projects accumulated in excess of \$326,000 upon completion.

housing development pursuant to the FHA's Section 236 program.

The earliest dated contracts were purchase agreements executed September 22, 1970. The terms of the purchase agreements called for the sale of 200 dwelling units for a total purchase price of \$2,720,000 for each of the locations. Stirling Homex was to pay for the shipment of the modules to their respective locations and only to supervise their installation.

PMM's workpapers also contained a feasibility letter dated January 8, 1971 addressed to the Virgin Islands Foundation for Housing and Economic Development ("VIFHED") St. Croix, Virgin Islands. This letter had an expiration date of 30 days and had not been renewed. PMM's personnel did not know of any relationship between the VIFHED and Quantum, nor did they do any follow-up procedures to determine whether the feasibility letter had been renewed.

A second agreement between Quantum and Stirling Homex, dated June 1, 1971, was also in PMM's work papers. This purchase agreement called for the purchase by Quantum of 100 dwelling units for a price of \$1,360,000 for each of the two sites or a total of \$2,720,000 for 200 dwelling units. According to the terms of this contract, payment was to be in the form of an irrevocable letter of credit to be issued by the First Pennsylvania Trust Company of Philadelphia. Other conditions set forth in the agreement were:

- (1) Approval of the modules by the FHA;
- (2) Payment was to be made on the issuance of an appropriate bill of lading; and
- (3) The modules were to be constructed in accordance with the plans and specifications.

The workpapers of PMM indicate that reliance for the commitment to fund the project was placed on the expired feasibility letter and on oral representations by the Company that a bank letter of credit had been furnished to Stirling Homex. In fact, a letter of credit had not been obtained by Stirling Homex at the time of PMM's audit and neither this letter of credit nor other financing was subsequently obtained.

On July 31, 1971, PMM sent a confirmation to Quantum to confirm information

concerning its contract with Stirling Homex dated September 22, 1970 of 400 dwelling units for \$5,400,000 with the terms of payment 10% of the units upon approval and acceptance of plans and specifications by mortgage and the balance upon acceptance of modules at the factory. The confirmation was returned marked incorrect and there was a letter attached which said there was a new contract dated June 1, 1971 for 200 dwelling units at \$2,720,000. In addition, the letter indicated that 10% of the contract price was to be paid upon approval and acceptance of the plans by the mortgagee and the balance upon acceptance of the modules at Stirling Homex's plant.

Moreover, in a note to its workpapers in the July, 1971 audit, PMM indicated the following as to this project: "FHA financing being processed by the LHA there so Stirling does not keep upon their progress. Stirling and PMM are relying on the bank letter of credit for the credibility of financing monies."

(b) *Clay, New York Project*

This project involved an application with FHA under a Section 236 program of 150 dwelling units for a total price of approximately \$3.5 million. The applicant on the project for which Stirling Homex was to be the builder was Clay Development Corp. ("Clay"), a wholly-owned Stirling Homex subsidiary. Clay, in turn, had an agreement with a non-profit sponsor under which the project would be purchased by the sponsor upon completion. In the closing days of the 1971 fiscal year, Stirling Homex recorded about \$2 million of modular sales on this project.

Sales were recognized on the basis of a feasibility letter dated July 30, 1971 from the FHA. The letter by its terms specified that its issuance was subject to receipt of an allocation of Federal funds. Further, the letter indicated that prior to the commencement of subsequent processing a municipal tax abatement for the project would be required. Thus, the letter did not evidence a firm commitment of financing. Had they extended their audit procedures, the auditors could have discovered that no commitment of federal funds had been made.

Additionally the purported arrangement between Clay and the non-profit sponsor for the resale of the project was a sham.⁸²

⁸² The non-profit sponsor for the project in fact had withdrawn at the time of the July 1971 audit. PMM was not aware of this fact.

Therefore the purported sale was only to Clay, a wholly-owned subsidiary of Stirling Homex. As such, it should have been reflected in the financial statements as a sales to an affiliated company.

(c) *Morgantown, West Virginia Project*

This project involved an application with FHA under Section 236 for 200 units for a total price of approximately \$4.3 million. During the fourth quarter of the 1971 fiscal year ended July 31, 1971, Stirling Homex recorded approximately \$2.5 million of modular sales on this project, using as a basis for evidence of firm commitment of financing on the project a letter dated July 30, 1971 from the FHA to Aquarius Development Corp. ("Aquarius"), a wholly-owned subsidiary of Stirling Homex. The project was the result of a contract between Aquarius and a non-profit entity.

The letter, while cast in the form of a feasibility letter, was in fact merely an offer to Aquarius to submit a revised application for a feasibility letter. It was not a firm commitment of financing and the Commission believes should not have been relied on as evidence of such a commitment. The modules that were supposedly manufactured for this project were structurally unsuitable because they were over two feet short of the required length. This proposed project was later abandoned for this reason and because of inability to obtain financing.

Moreover, as in the case of the Clay project, the purported agreement to sell the project to a non-profit sponsor was a sham.

(d) *Stanley Simon Project*

In the 1971 fiscal year ended July 31, 1971 modular manufacturing sales of nearly \$6.3 million were recorded on this project on the basis of an agreement dated April 23, 1971 between Stirling Homex and Stanley Simon and Associates ("Simon") acting on its behalf and behalfs of limited partnerships to be formed in the future. The agreement provided for the purchase of 1,000 modules at \$11,000 per module for a total price of \$11,000,000. It called for a \$25,000 down payment on each site with the projects to be financed conventionally

rather than through government programs. Each site for the modules was to be approved by both parties. For the most part, there was no commitment of financing on the project and there was no assurance that Simon would be able to arrange such financing.⁶⁶ In early July, 1971 Stanley Simon and Stirling Homex began drafting a contract to cover the 1,000 module units pursuant to the terms set forth in the April 23rd letter of understanding but this contract was never finalized.

During the July 31, 1971 audit, PMM's personnel realized that a firm commitment of financing was unavailable inasmuch as they specifically noted in their workpapers that financing for this project was "pending." The review notes compiled by the PMM audit manager indicate that as late as September 23, 1971, subsequent to the date of PMM's report, PMM should "obtain proof of 100% permanent financing."

A PMM partner was aware that financing was not committed for the sales recorded on the Simon project by the close of the 1971 fiscal year and not obtained during the audit period. He was not concerned with the absence of any firm commitment because he relied on the reputation of Simon personally and the fact that Simon was known to be a man of considerable wealth. The partner felt that this was sufficient reason to permit income recognition on the project.

(e) *Stirling Homex Accounts Receivable as of July 31, 1971*

Receivables associated with revenues recorded in fiscal 1970 on many of the projects discussed above were still carried as receivables at the end of fiscal 1971.⁶⁷ There is evidence in the PMM workpapers that there were substantial problems with respect to many of these projects. The Commission believes that PMM failed to take adequate audit steps to assess the significant representations of Stirling Homex management which were received in response to the auditors' inquiries.

Listed below are several examples:

(1) *Pittsburgh Project Receivable of \$444,000.* PMM was informed by Stirling Homex

full sale price (\$1,232,000). As for the remaining module sales reported as attributable to the Simon contract, no revenues should have been recognized because of the lack of evidence of permanent financing.

⁶⁷ Approximately \$36,400,000 of accounts receivable out of \$37,850,000 total accounts receivable were improperly included as assets.

⁶⁶ The only evidence that was submitted to PMM that any permanent financing had been obtained, was a commitment dated July 19, 1971 by the Dime Savings Bank of Williamsburg ("DSBW") to make a first mortgage loan in the amount of \$25,000 for a 112 unit development to be constructed in Utica, New York. The commitment by the DSBW was short in the amount of \$283,000 required to make up the

that HUD had expressed reservations about the project site and Stirling Homex had indicated it could substitute another site if necessary. There is no indication that PMM examined any correspondence or other documentary support for this statement by management.

(2) *Washington Project Receivable of \$678,400.* PMM was informed during the 1971 fiscal year audit of the substantial delays being experienced with respect to this project because of the necessity of obtaining numerous approvals.

(3) *Grandview, Erie Project Receivable of \$1,269,000.* During the 1971 fiscal year this project was substituted for the 37th and Tuttle Street Project in Erie, Pennsylvania, on which sales were recorded during Stirling Homex's 1970 fiscal year pursuant to an agreement with the LHA. As noted in their workpapers, the auditors were aware of the "political and community entanglements" being experienced by Stirling Homex.

(4) *Bridgeport Project Receivable of \$329,500.* PMM knew that this receivable was troublesome because no new replacement site had been located for the previously abandoned site and any replacement site was subject to HUD's approval.

(5) *Mississippi GGC Receivable of \$8,520,400.* PMM learned during the 1971 fiscal year audit that Stirling Homex was making application and seeking approval for several sites through the Farmers Home. PMM learned that a \$750,000 "prototype" project proposal for 50 out of the 800 units had not received final approval by the time the audit was being performed.²² Moreover, the modules had not been shipped to Mississippi.

(6) *Hillwood Project Receivable of \$7,240,000.* This project, which had been carried as a receivable by Stirling Homex since October of 1969, had almost no site work accomplished and was encountering

zoning problems. Stirling Homex had reduced the number of modules for this project. Despite the size and age of this proposed project PMM took no extended audit steps with respect thereto.

(7) *Highland Project Receivable of \$3,352,000.* At the close of the 1971 fiscal year of Stirling Homex, there had been no progress on this project even though it was a large receivable and had been recorded in the 1970 fiscal year of Stirling Homex. The project site had been switched from the Highland Street, Akron location to a completely different site in East Barberton, Ohio. The sales that had supposedly represented the Highland project were not reversed on this project but merely switched to the Barberton Project. However, in October of 1971, Stirling Homex entered into an entirely new contract of sale which was approved by HUD and the project was ultimately completed and paid for.

Cost Overruns on Stirling Homex Projects

By the close of its 1971 fiscal year, Stirling Homex had incurred over \$1 million of cost overruns on various projects, which were carried on its books as receivables. Further, Stirling Homex carried an additional \$1,000,000 of cost overruns as *Contracts in Progress*.²³ These cost overruns represented additional costs incurred by Stirling Homex in excess of that portion of the contract price allocated to installation sales, which additional costs had not been and were not reimbursable under the terms of the applicable contracts. The existence of these cost overruns was not properly accounted for in Stirling Homex's financial statements nor disclosed in the accompanying footnotes.

Despite the unusual nature and size of these cost overruns PMM did not undertake adequate audit steps in that it failed to obtain reliable support for their collectibility.

²² In fact, by the time of the PMM audit, the project had been rejected by the Farmers Home. This was not known to PMM.

²³ Stirling Homex improperly classified as an asset certain costs and expenses amounting to approximately \$832,000 for the seven months ended February 28, 1971 and \$1 million for the fiscal year ended July 31, 1971 which related to the construction of a proposed Mississippi plant to be financed by a \$5 million industrial bond offering. This classification permitted these amounts to be capitalized rather than expensed during the period in which they were incurred, and resulted in an overstatement of net income for said periods. PMM's acceptance of this classification was inappropriate in that

reimbursement was unlikely under the terms of the trust indenture, a substantial portion of the expenses were general and administrative expenses, and the reimbursement of the \$1 million in intangible expenses from the offering proceeds was highly unlikely since they represented 20% of the total proceeds. Stirling Homex incurred these cost overruns because of delays caused by Stirling Homex's premature manufacture of modules, which were in large part motivated by the Company's income recognition policies. These delays caused increased expense such as storage costs, module refurbishment, and dissatisfaction with the Stirling Homex product by some customers.

Subsequent Discovery of Improper Business Activities

After being shown Stirling Homex's Form 10-Q for the period ended October 30, 1971, PMM personnel learned that the \$2,720,000 in modular sales for the Thomasville and St. Croix projects had been reversed, that the modules had been reasigned to another project and that these facts were not publicly known. The Company advised PMM that this was an unusual nonrecurring transaction occasioned by events which took place after July 31, 1971.

Even though PMM personnel knew of these reversals and their possible effect on the audited financial statement for the July 31, 1971 period, they failed to follow auditing procedures that should be complied with in such circumstances to determine whether these reversals required modification or withdrawal of PMM's report on the July 31, 1971 financial statements.⁹⁰

During March of 1972, PMM objected to the Company's recognition of a very large amount of income on two newly begun projects involving private financing. As a consequence, income from these projects was not reflected in Stirling Homex's financial statements for the period and the Company reported a substantial loss from operations for the quarter.⁹¹

In May of 1972, PMM auditors were told by management that Stirling Homex's financial condition was deteriorating rapidly and that it would report a \$20 million loss for the nine months ended April 30, 1972, including substantial charges against income for the period resulting from a reduction in the sales price of modules on certain projects upon which revenue had been recognized in prior fiscal periods, a provision for the repair and refurbishing of 10,000 uninstalled modules in storage areas of the company, a provision for estimated additional costs of construction on the Stanley Simon project, a provision for doubtful accounts with respect to the cost overruns which were included in accounts

receivable and a provision for various over-run costs incurred in connection with the construction of several projects.

The auditors were completely "dumbstruck" by this recital by Stirling Homex management. They failed to undertake any review or investigation to ascertain whether the newly discovered facts existed at the date of their report on Stirling Homex's financial statements. Due to the nature of these extraordinary charges, it should have been clear to them that the previous financial statements of Stirling Homex were seriously deficient.

Statements to the Commission Staff

On July 7, 1971 a meeting was held at the Commission in connection with the then pending registration statement of Stirling Homex to discuss the Division of Corporation Finance's letter of comments. Present at this meeting were representatives of Stirling Homex, its outside counsel, underwriters and partners of PMM.

The meeting began with a general discussion concerning the staff's letter of comments.⁹² Then a more particularized discussion took place concerning Stirling Homex's income recognition policies, with the client partner of PMM asking whether the staff of the Commission desired Stirling Homex to recognize on the completed contract method. He questioned this method and stated that under the circumstances this method would not be in accord with generally accepted accounting principles.

The PMM partner stated that the real question was not a matter of mechanical application of accounting theory but rather at what point in time sales should be recognized and what event should have transpired prior to recognition. He then outlined four events that had occurred prior to recognition of income by Stirling Homex, which in effect, would remove any credit risk. The most important of these events that he outlined was that there was a commitment of permanent financing to purchase the project.

⁹⁰ See Statement on Auditing Standards 1 at Section 561.01 ff. ("Subsequent Discovery of Facts Existing at the Date of the Auditor's Report").

⁹¹ This announcement started the chain of events which led to the ultimate bankruptcy of the Company in July 1972.

⁹² One of the matters under discussion was a certain land sale. PMM originally advised Stirling Homex that the transaction as originally structured would not, in its opinion, qualify for

income recognition but indicated that if the transaction were restructured to bring it within the real estate guidelines then being applied generally by PMM, income would properly be recorded. The transaction was then restructured along the lines advised by PMM, and PMM gave its opinion to Stirling Homex management that income could be recognized. During the meeting the Commission's Division of Corporation Finance indicated its disagreement with PMM's views and the sale was reversed.

A number of statements by the partner were largely inaccurate. Very few of Stirling Homex's projects were covered by permanent financing. Had he made appropriate verification during the earlier audit period or prior to the Commission meeting, he would have known that these statements were not true.

The oral statements of the partner were subsequently confirmed in the supplemental submission submitted by Stirling Homex in July 1971. The purpose of this submission was to outline Stirling Homex income recognition policies for the staff of the Commission in an attempt to dissuade the staff from insisting on the completed contract method of income recognition.²²

It contained numerous false statements, including misrepresentations concerning the turnkey and other government programs as utilized by Stirling Homex and the fact that Stirling Homex had fulfilled certain conditions precedent before including its projects in sales.

CONCLUSIONS

As illustrated above, the Commission believes that PMM failed in a number of material respects to conduct the February 28, 1971 and July 31, 1971 audit engagements in accordance with generally accepted auditing standards.

Valuable lessons can be derived from PMM's conduct, which, if focused upon, will hopefully prevent similar occurrences in the future. The facts of this case suggest that for a new and unknown client, some independent investigation should be made of the company, its customers and methods of doing business. When a client extensively utilizes government programs and contracts, it is expected that the auditors will have a thorough and complete familiarity with the programs.

In addition, care should be given to the organization of the "audit team" so that responsibilities are clearly defined. With respect to the Stirling Homex audit, the presence of two partners operating out of different offices supervising the same audit work gave rise to a situation where important decisions were deferred and the division of responsibility was not clear. As a result, it was difficult to coordinate effective control over the audit and the decision making process with respect thereto. This

situation permitted vacillation on major decisions which ultimately were never satisfactorily resolved by either partner.

During the audit of Stirling Homex, the SEC review by PMM's SEC reviewing partner was superficial although the audit was one where it had been determined that an "in depth" review was required.

A successor auditing firm should review the working papers of the predecessor auditors. Such review should cover critical audit areas and unusual accounting matters. It should also cover disagreements between the predecessor auditors and management, whether or not they are satisfactorily resolved, which relate to accounting principles, auditing procedures, and the predecessor's understanding regarding the reasons for the change of auditors. Further, successor auditors should always be alert to factors bearing on the integrity of management.

A major deficiency of the Stirling Homex audit was PMM's reliance on the unsupported, undocumented representations of management. An auditor should not rely solely on the representations of management, but satisfy themselves as to such matters by other means consistent with the circumstances of the particular transaction, such as independent documentary verification.

Auditors should be wary when sales and income are sought to be recognized on the basis of assumptions and projections as to future events necessary for the ultimate realization of such income. In this case, sales and income were recognized on government financial housing projects at an early stage in the processing of the projects and at a point where the essential commitment of government financing was not in existence and where the projects were still subject to a variety of conditions such as the politically explosive issue of site selection of low income housing. The auditors, in part because of their unfamiliarity with government housing programs, accepted optimistic and in some cases deceitful representations of the company and others regarding the programs and projects in question. The Commission believes that in cases such as these where income recognition occurs well before the point at which the customer is normally billed, auditors should exercise a high degree of caution and skepticism.

²² These elements are substantially the same elements discussed in connection with Stirling

Homex's accounting methods. See discussion above.

Also we believe that auditors have a duty to disclose subsequently acquired information which existed at the date of the auditor's report and establishes that previously reported upon financial statements are materially false and misleading. On two occasions during the 1972 Stirling Homex fiscal year, PMM learned information, which if PMM had investigated as they should have, would have disclosed to PMM that earlier prepared financial statements of Stirling Homex were materially false.

Finally, it must be noted that the statements made by the PMM partner to the Commission staff in connection with discussions of the Stirling Homex registration statement constitute unacceptable professional behavior in practice before the Commission. Independent professional accountants should not act as advocates on behalf of their clients before the Commission, especially when the accountant is making factual statements about a particular client's business which have not been verified. As the Commission recently stated:

"The Commission and its staff do not and cannot investigate representations made to it, but must be able to rely on their completeness if this process is to work. The objectives of the securities laws can only be achieved when those professionals who practice before the Commission, both lawyers and accountants, act in a manner consistent with their responsibilities. Professionals involved in the disclosure process are in a very real sense the representatives of the investing public served by the Commission, and, as a result their dealings with the Commission and its staff must be permeated with candor and full disclosure. It cannot resemble an adversary relationship more appropriate to litigants in court, because the Commission is not an adverse party in this context. All who are familiar with the Commission's policies know that too much importance is attached to the word of the professional, to permit his or her word to become the subject of question. A professional's word is often the functional equivalent of his or her reputation. Conferences with the staff of the Commission serve a vital

role in the administration of the securities laws, and such conferences are predicated, for the most part, upon full disclosure by the professionals involved. It must be understood by all who practice before the Commission, lawyers and accountants alike, that the Commission and its staff cannot tolerate less than full disclosure."

¹¹ See *In the Matter of Arthur Andersen*, ASR #157, Exchange Act Release #10906.

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EXHIBIT 3

Indictment in *United States of America v. David Stirling, Jr., et al.*, U.S.D.C., S.D.N.Y., 76 Crim. 0685

(Reproduced herein as pages A299 to A311)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

A 299

UNITED STATES OF AMERICA :

- v - :

DAVID STIRLING, JR.,
WILLIAM G. STIRLING,
HAROLD M. YANOWITCH,
EDWIN J. SCHULZ, and
RUBEL L. PHILLIPS,

Defendants. :

INDICTMENT

76 Cr.

76 CRIM 0685

COUNT ONE

The Grand Jury charges:

INTRODUCTION

1. At all relevant times, the Stirling Homex Corporation ("Homex") was incorporated under the laws of the State of Delaware and maintained offices in the Southern District of New York and elsewhere. Homex was principally engaged in the business of manufacturing and installing factory-built modular housing.

2. On or about February 19, 1970, Homex registered 1,175,000 shares of its common stock for sale with the Securities and Exchange Commission ("SEC"), an agency of the United States, and sold that stock to members of the public for approximately \$19,000,000; on or about July 29, 1971, Homex registered 500,000 shares of its preferred stock for sale with the SEC and sold that stock to members of the public for approximately \$20,000,000; thereafter there existed in New York, New York, and elsewhere, a public over-the-counter market for Homex common and preferred stock. Less than a year later, on July 12, 1972, Homex was bankrupt.

3. At all relevant times, defendant DAVID STIRLING, JR., was the chief executive officer of Homex, chairman of its board of directors and the owner of a controlling block

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of approximately 2,000,000 shares of Homex common stock. On February 19, 1970, he sold 110,100 shares of his Homex common stock for approximately \$1,600,000.

4. At all relevant times, defendant WILLIAM G. STIRLING was the president of Homex, a member of its board of directors and the owner of a controlling block of approximately 2,000,000 shares of Homex common stock. On February 19, 1970, he sold 112,000 shares of his Homex common stock for approximately \$1,700,000.

5. Beginning in or about 1968 and at all relevant times thereafter, defendant EDWIN J. SCHULZ was an employee of Homex, its chief accounting officer and the owner of 3,200 shares of Homex common stock.

6. Beginning in or about 1969, and at all relevant times thereafter, defendant HAROLD M. YANOWITCH, an attorney, was an employee of Homex, a member of its board of directors, its chief legal officer and the owner of approximately 160,000 shares of Homex common stock.

7. Beginning in or about 1971, and at all relevant times thereafter, defendant RUBEL L. PHILLIPS, an attorney, was an employee of Homex with an office in Jackson, Mississippi and the owner of an option to purchase 40,000 shares of Homex common stock.

I. FRAUD SCHEME

8. From on or about the 1st day of January, 1968, and continuously thereafter up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, the defendants, and others to the Grand Jury known and unknown, did employ a device, scheme, and artifice to

defraud Homex's shareholders, officers, directors and others including its auditors, in connection with the offer and sale of securities, to wit, common and preferred stock of Stirling Homex Corporation.

II. THE OBJECT OF THE SCHEME

9. It was the object of said scheme deliberately to deceive members of the public investing in Homex securities by fraudulently inflating reported earnings and simultaneously falsifying and concealing materially adverse information required to have been fairly and truly disclosed.

III. THE MEANS BY WHICH THE FRAUD SCHEME WAS CARRIED OUT

10. It was a part of said scheme to defraud that in 1969, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH and EDWIN J. SCHULZ falsely inflated revenues and profits by arranging two "sales" of land at artificially high prices that were induced by and based upon side promises and guarantees given to the buyers. In connection therewith, the defendants signed and filed registration statements with the SEC which fraudulently concealed the following essential facts, among others, about these "sales" which accounted for 18% of net income for the fiscal year ending July 31, 1969: (a) both "sales" involved side promises and agreements given to the buyers including limitations on and guarantees against losses; (b) both "sales" required only minimal down payments with the remainder of the purchase payment being largely postponed for several years; and (c) both "sales" were to financially weak shell corporations without sufficient means to meet the payment obligations.

11. It was further a part of said scheme to defraud that during 1970 and 1971 the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, and EDWIN J. SCHULZ, would prepare, file with the SEC, and distribute to shareholders annual and interim reports which fraudulently omitted to disclose, among other things: (a) that such "sales" were not being consummated; (b) that in one instance, persons affiliated with or controlled by Homex were substituted as owners of the shell corporation and were secretly guaranteed against losses and indirectly provided with Homex funds to make periodic payments toward the unpaid purchase obligation; and (c) that the payment obligations arising from these "sales" were in fact uncollectible.

12. It was further a part of said scheme to defraud that in 1971 the defendant, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, and EDWIN J. SCHULZ falsely inflated revenues and profits by arranging a third "sale" of land at an artificially high price that was induced by and based upon secret promises and guarantees given to the buyers. In connection therewith, the defendants prepared and filed registration statements and quarterly reports with the SEC which fraudulent concealed the following essential facts, among others, about this "sale" which accounted for nearly half of Homex's earnings for the first half of the fiscal year ending July 31, 1971: (a) that such "sale" involved side promises and agreements given to the buyers including guarantees against losses; (b) that such "sale" involved only a minimal downpayment, borrowed through the use of Homex collateral, with the remainder of the purchase payment being postponed several years; (c) that such "sale" was at a price which had been artificially raised; and (d) that such "sale" was to a financially weak

shell corporation, without sufficient means to meet the payment obligations, and which was owned by individuals associated with a business which, in turn, had derived a material portion of its past revenues from dealings with Homex.

13. It was further a part of said scheme to defraud that in or about July 1971, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH and EDWIN J. SCHULZ prepared, signed and filed with the SEC registration statements and other written representations which falsely and fraudulently stated that Homex recognized income from sales of modules when manufactured modules were assigned to specific contracts. That representation was false because, as the defendants well knew, such assignments had been repeatedly cancelled or reversed with the modules then being reassigned from project to project until, for example, by February 28, 1971, a total of approximately \$13,500,000 of such sales had been written on and off and back onto Homex's books of account. This history of mass reassignments was deliberately withheld from both Homex's auditors and the SEC.

14. It was further a part of said scheme to defraud that during 1971 defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULTZ, and RUBEL L. PHILLIPS fraudulently and falsely inflated Homex's sales and earnings by arranging for a purported arms-length "sale" of modules for \$15,000,000 which was induced by and based upon a forged commitment letter and by secret side promises and agreements given to the buyers. In connection therewith, the defendants prepared and filed registration statements and other reports with the SEC which fraudulently concealed the following essential facts, among others, about

this "sale" which accounted for more than half of Homex's earnings for the nine-months ended April 30, 1971, and all of its earnings for the six months ended January 31, 1971: (1) that such "sale" was based upon a back dated contract not entered into until on or about February 24, 1971, well after the relevant accounting period had ended; (b) that, while said "sales" contract was expressly conditioned on Homex's manufacturing the modules in Mississippi and Homex's obtaining federal funding, in point of fact, Homex had not satisfied either condition; (c) that the purchaser was a financially weak shell corporation, without sufficient means to meet the payment obligations, which Homex had caused to be formed in the first place; and (d) that, during March, 1971, the defendant HAROLD M. YANOWITCH, had employed the forged commitment letter to defraud Homex's auditors into certifying its financial statements.

15. It was further a part of said scheme to defraud that defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and RUBEL L. PHILLIPS fraudulently and falsely inflated and overstated Homex's publicly reported assets, revenues and earnings while also fraudulently understating its liabilities, reserves and expenses. In connection therewith, the defendants deliberately falsified and concealed from Homex's auditors material information as to adjustments in its accounts including those relating to: (a) installation division revenues and costs for the period ending July 31, 1970; (b) U.S. Shelter revenues for the period ending February 28, 1971; and (c) deferred, general and administrative expenses for the period ending February 28, 1971.

16. It was further a part of said scheme to defraud that on or about July 29, 1971, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, and HAROLD M. YANOWITCH prepared and filed with the SEC registration statements and other reports which described Homex's several relations with the United Brotherhood of Carpenters and Joiners of America and its locals. Those statements were materially false and misleading, because as the defendants well knew, but failed to disclose, even members and officials of the United Brotherhood of Carpenters and Joiners of America had been paid off by having approximately \$240,000 worth of Homex common stock purchased for them at approximately \$76,800 less than the fair market value, and afterwards, when the fair market price had fallen, approximately \$64,000 worth of Homex common stock sold for them at approximately \$136,000 above the market price.

IV. STATUTORY ALLEGATIONS

17. From on or about the 1st day of January 1968, up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and RUBEL L. PHILLIPS, and others to the Grand Jury known and unknown, unlawfully, willfully and knowingly, by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, in the offer and sale of securities, to wit, the common and preferred stock of Stirling Homex Corporation: (a) did employ devices, schemes and artifices to defraud; (b) did obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make

the statements made, in the light of the circumstances under which they were made, not misleading; and (c) did engage in transactions, practices and courses of business which operated and would operate as a fraud and deceit upon the purchasers of Stirling Homex Corporation securities.

(Title 15, United States Code, Sections 77q(a) and 77x and Title 18, United States Code, Section 2.).

COUNT TWO

The Grand Jury further charges:

1. On or about July 29, 1971, in the Southern District of New York, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, unlawfully, wilfully and knowingly made and caused to be made untrue statements of material facts in a registration-statement and omitted to state material facts required to be stated therein and necessary in order to make the statements therein not misleading.

2. Said registration statement as amended covered 500,000 shares of Homex preferred stock and was required to be filed and was filed with the SEC pursuant to Title 15, United States Code, Sections 77e through 77h and 17 C.F.R. §§ 230.400 to 230.499 and 239.11 promulgated by the SEC thereunder.

3. Each of the allegations in Count One of this Indictment is incorporated and realleged in this Count as if fully set forth herein.

(Title 15, United States Code, Section 77x and Title 18, United States Code, Section 2.).

COUNTS THREE THROUGH EIGHT

The Grand Jury further charges:

1. From on or about January 1, 1968, up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J.

SCHULZ, and RUBEL L. PHILLIPS, the defendants, and others to the Grand Jury known and unknown, unlawfully, wilfully and knowingly did devise and intend to devise a scheme and artifice to defraud the purchasers of Stirling Homex Corporation securities and other persons, and to obtain money and property by means of false and fraudulent pretenses, representations and promises and, for the purpose of executing said scheme and artifice to defraud and attempting so to do, did place and cause to be placed in post offices and authorized depositories for mail matter, did take and receive therefrom, and did cause to be delivered by mail according to the directions thereon certain mail matter to be sent and delivered by the Postal Service as hereinafter set forth.

2. Each of the allegations contained in Count One of this indictment is repeated and realleged as though fully set forth herein as constituting and describing the means by which the defendants committed the offenses charged in Counts Three through Eight of this Indictment.

3. On or about the dates hereinafter set forth in Counts Three through Eight of this Indictment, in the Southern District of New York, said defendants unlawfully, wilfully and knowingly did place and caused to be placed in post offices and authorized depositories for mail and did cause to be delivered by mail according to the directions thereon, the matter hereinafter set forth:

<u>Count</u>	<u>Date</u>	<u>Matter</u>	<u>Addressee</u>
3	8/2/71	Prospectus	Peter R. Cottrell & Mary Lee Cottrell, JT TEN 115 Clinton Street Mount Vernon, N.Y. 10552
4	8/2/71	Prospectus	Ror-ld J. Benice & Doris P. Benice 25 Stewart Place Mt. Kisco, N.Y.

<u>Count</u>	<u>Date</u>	<u>Matter</u>	<u>Addressee</u>
5	10/8/71	1971 Annual Report	Joseph Szymanski 200 West 18th St. New York, New York
6	10/8/71	1971 Annual Report	Peter R. Cottrell & Mary Lee Cottrell, TEN 115 Clinton Street Mount Vernon, N.Y. 10552
7	12/6/71	Quarterly Report to Shareholders	Joseph Szymanski 200 West 18th Street New York, N.Y.
8	12/6/71	Quarterly Report to Shareholders	Nobumitsu Fukui 53 Greene Street New York, N.Y. 10013

(Title 18, United States Code, Sections 1341 and 2.)

COUNT NINE

The Grand Jury further charges:

1. From on or about the first day of January 1968, and continuously thereafter up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, the defendants, and others to the Grand Jury both known and unknown, unlawfully, wilfully and knowingly did combine, conspire, confederate and agree together and with each other to defraud the United States and the SEC and to violate Sections 1001 and 1341 of Title 18 and Sections 77q (a), 77x, and 78ff of Title 15, United States Code.

2. It was a part of said conspiracy that the defendants unlawfully, knowingly and wilfully, in matters within the jurisdiction of departments and agencies of the United States, would and did falsify, conceal and cover up by trick, scheme and device material facts, and make false, fictitious and fraudulent statements and representations, and make and use false writings and documents knowing the same to contain false, fictitious and fraudulent statements and entries in violation of Section 1001 of Title 18, United States Code.

3. It was a further part of said conspiracy that the defendants unlawfully, wilfully and knowingly, would and did devise and intend to devise a scheme and artifice to defraud the purchasers of Stirling Homex Corporation securities and other persons, and to obtain money and property by means of false and fraudulent pretenses, representations and promises and, for the purpose of executing said scheme and artifice to defraud and attempting so to do, would and did place and cause to be placed in post offices and authorized depositories for mail matter, take and receive therefrom, and cause to be delivered by mail according to the directions thereon certain mail matter to be sent and delivered by the Postal Service in violation of Section 1341 of Title 18, United States Code.

4. It was further a part of said conspiracy that the defendants unlawfully, wilfully and knowingly, by use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, in the offer and sale of securities, to wit, the common and preferred stock of Stirling Homex Corporation:

- (a) did employ devices, schemes and artifices to defraud;
- (b) did obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;
- and (c) did engage in transactions, practices and courses of business which operated and would operate as a fraud and deceit upon the purchasers of Stirling Homex Corporation securities in violation of Section 77q(a) of Title 15, United States Code.

5. It was further a part of said conspiracy that the defendants unlawfully, wilfully and knowingly would and did make untrue statements of material facts in registration statements required to be filed with the SEC and omitted to state material facts required to be stated therein and necessary in order to make the statements therein not misleading in violation of Section 77x of Title 15, United States Code.

6. It was further a part of said conspiracy that the defendants unlawfully, wilfully and knowingly would and did make false and misleading statements with respect to material facts in annual and quarterly reports required to be filed with the SEC in violation of Section 78ff of Title 15, United States Code.

OVERT ACTS

7. Each of the allegations contained in Count One of this Indictment is repeated and realleged as though fully set forth herein as constituting and describing some of the overt acts by which the defendants committed the offense charged in Count Nine of this indictment. In addition, in furtherance of the said conspiracy and to effect the objects thereof, the defendants did commit the following additional overt acts, among others, in the Southern District of New York and elsewhere:

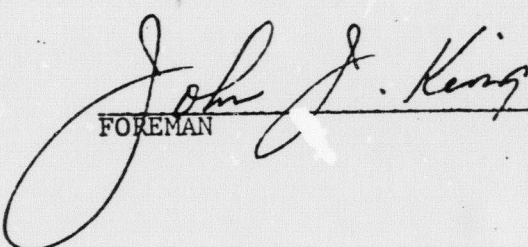
(1) On or about February 19, 1971, June 30, 1971 and July 6, 1971, defendant EDWIN J. SCHULZ attended meetings in New York, New York.

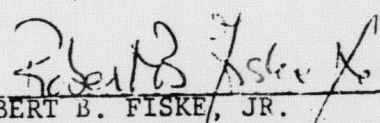
(2) On or about March 1, 1971, defendant HAROLD M. YANOWITCH wired copies of forged and backdated documents to Homex's New York, New York offices.

(3) On or about August 5, 1971, defendant HAROLD M. YANOWITCH attended a closing in New York, New York where the \$19,000,000 from the sale of the preferred stock was paid.

(4) On or about December 6, 1971, DAVID STIRLING, JR., and WILLIAM G. STIRLING signed and caused to be delivered in the Southern District of New York a quarterly report to shareholders.

(Title 18, United States Code, Section 371.)


FOREMAN


ROBERT B. FISKE, JR.
United States Attorney

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EXHIBIT 4

Bill of Particulars in *United States of America v. David Stirling, Jr., et al.*, U.S.D.C., S.D.N.Y., 76 Crim. 0685

(Reproduced herein as pages A313 to A333)

UNITED STATES OF AMERICA, :

- v - :

DAVID STIRLING, et al., :

Defendants. :

BILL OF PARTICULARS

76 Cr. 685 (MEF)

S I R S :

The United States of America, as and for its Bill of Particulars herein, alleges:

1. Unless the context otherwise requires, in all counts of the Indictment and throughout this Bill of Particulars (and supplements hereto), the phrase "at all relevant times" generally encompasses the period commencing on or about January 1, 1968, and concluding on or about July 12, 1972. Additionally, and unless the context indicates otherwise, in all Counts of the Indictment, the persons alleged to have been defrauded generally include all segments of the Homex investing public including for example, but not limited to: (a) actual purchasers and sellers of Homex common and preferred stock; (b) prospective purchasers and sellers of Homex common and preferred stock; (c) lenders and prospective lenders against the collateral value of Homex common and preferred shares, debentures, notes or other Homex securities of whatsoever kind; (d) persons interested in and otherwise associated with the issuance, purchase and sale of Homex securities including, for example, the SEC, the IRS, HUD, Homex's auditors, bankers (investment and commercial), underwriters, employees, attorneys and agents, etc. Unless the context indicates otherwise, the Government will claim

that each defendant did the acts only where the direct and circumstantial proof properly admits of such an argument; otherwise the Government will contend that the person personally performing the act did so as part of a criminal venture which counted each defendant as having a stake in its outcome. The following co-conspirators were not identified in the Indictment: S. Ruggiano, R. E. Livingston, P. J. Campbell, W. Konyha, B. A. Frank, Marty Frank, E. E. Jacobs, Jr., M. Marsh, J. J. Catalfano, Frank Csapo, Homex and its subsidiaries, and S. J. Giovino.

2. The defendants fraudulently inflated Homex earnings during all relevant times and, accordingly, its earnings during each and every accounting period from August, 1968, through July, 1972, were overstated by material amounts. Similarly, the defendants fraudulently falsified and concealed adverse information during all relevant times, and, accordingly, after its occurrence, such was not disclosed throughout the period from August, 1968, through July, 1972. The Homex monthly general journal and ledgers have been partially numbered with identification numbers 205,095-930 and 210,961 through 211,064, and some Homex monthly financial statements have been marked as 200,639-201,083 and 202,142-203,999. Homex financial statements filed with the SEC have been marked as Government's Exhibits 1 through 29 as follows:

- GX 1 Registration statement filed 10/1/69 for 325,000 Homex common shares signed by HMY for himself and as agent for DS, WGS and EJS (42477-42516).
- GX 2 Power of Attorney for GX 1 signed by HMY, DS, WGS and EJS (42517-8).
- GX 3 Exhibits to GX 1 filed 10/1/69 (42519).

- 71-5555
3-223
- GX 4 Amended registration statement filed 2/17/70 for 1,175,000 Homex common shares signed by HMY for himself and as agent for DS, WGS and EJS (42521-42547).
- GX 5 Effective registration statement filed 2/19/70 for 1,175,000 Homex common shares signed by HMY for himself and as agent for DS, WGS and EJS (42551-42601).
- GX 6 Amended registration statement filed 7/16/71 for 25,000 Homex common shares signed by HMY for himself and as agent for DS, WGS and EJS (42603).
- GX 7 Effective registration statement filed 8/23/71 for 25,000 Homex common shares signed by DS for himself and as agent for WGS, HMY and EJS (42605).
- GX 8 Registration statement filed 4/21/71 for 1,025,000 Homex common shares signed by HMY, DS, WGS and EJS (42978).
- GX 9 Exhibits to GX 8 filed 4/21/71 (42979-43153).
- GX 10 Amended registration statement filed 5/28/71 for 500,000 Homex preferred shares signed by HMY for himself and as agent for DS, WGS and EJS (43161).
- GX 11 Amended registration statement filed 7/16/71 for 500,000 Homex preferred shares signed by HMY for himself and as agent for DS, WGS and EJS (43162).
- GX 12 Effective registration statement filed 7/29/71 for 500,000 Homex preferred share signed by HMY for himself and as agent for DS, WGS and EJS (43168).
- GX 13 Form 9K semi-annual report filed 3/18/70 for the six months ending 1/31/70 (42626-7).
- GX 14 Homex's 1970 proxy filed 1/11/71 (42630).
- GX 15 Form 10K annual report filed 11/30/70 for the year ending 7/31/70 (42632).
- GX 16 Homex's 1971 Proxy filed 10/12/71 (42034).
- GX 17 Form 10K annual report filed 10/27/71 for the year ending 7/31/71 signed by HMY (42636-42673).
- GX 18 Form 10Q Quarterly report filed 3/16/71 for the six months ended 1/31/71 signed by EJS (42634-639).

- GX 19 Form 8K monthly report filed 3/3/71 for the month of February 1971 (42691-2).
- GX 20 Form 10Q Quarterly Report filed 5/17/71 for the nine months ended 4/30/71 signed by EJS (42694-42700).
- GX 21 Form 8 Amendment to 1971 10K filed 2/10/72 signed by HMY (42703-3).
- GX 22 Form 8K monthly report filed 9/20/71 for the month of August 1971 (42705-6).
- GX 23 Form 8K monthly report filed 10/14/71 for the month of September 1971 (42708-9).
- GX 24 Form 10Q Quarterly report filed 12/15/71 for the 3 months ended 10/31/71 (42711-716).
- GX 25 Form 10Q Quarterly Report filed 3/16/72 for the six months ended 1/31/72 (42724-731).
- GX 26 Form 8K monthly report filed 5/12/72 for the month of April 1972 (42732-5).
- GX 27 Form 8K monthly report filed 6/12/72 for the month of May 1972 signed by HMY (42735-8).
- GX 28 Form 10Q Quarterly report filed 6/12/72 for the nine months ended 4/30/72 (42740-47).
- GX 29 Form 8K monthly report filed 8/17/72 for month of July 1972 (42749-52).

Each of these account entries and financial statements contains, inter alia, cumulating current and retained earnings and receivables which account for the "sales" transactions identified in the Indictment and subparagraphs (a) through (j) of this Bill of Particulars. Defendants wholly failed to establish the reserves or write-offs necessary to a truthful statement of Homex's financial position. Numerous devices and tricks were employed during each accounting period to improve Homex's financial appearance. Without limiting the generality of the foregoing, the following specifics are herein set forth as some, but not all, of the "sales" transactions involved in the scheme to defraud, together with some, but not all, of the withheld adverse information:

(a) Fiscal Year Ending 7/31/69

The Homex consolidated financial statements for the fiscal year ending July 31, 1969, which reported total sales of approximately \$10,000,000, materially overstated such sales and the related receivables, as a result of the improper inclusion therein of the following projects:

<u>PROJECT</u>	<u>LOCATION</u>	<u>SALES AMOUNTS</u>
Kece, Ltd.	Clay, N.Y.	\$325,000
Reseac Realty, Inc.	Clay, N.Y.	\$425,000

(b) Fiscal Periods Ending
12/31/69 and 1/31/70

The Homex consolidated financial statements for the five and six months fiscal periods ending 12/31/69 and 1/31/70 which reported total sales of approximately \$7,600,000 and \$10,500,000, respectively, materially overstated such sales as a result of the improper inclusion therein of the Hillwood project in Akron, Ohio.

(c) Fiscal Year Ending 7/31/70

The Homex consolidated financial statements for the fiscal year ending July 31, 1970, which reported total sales of approximately \$22,500,000, materially overstated such sales by approximately \$10,528,000 as a result of the improper inclusion therein of the following projects:

<u>PROJECT</u>	<u>LOCATION</u>	<u>AMOUNTS</u>
Hillwood Homes	Akron, Ohio	\$5,229,200
Highland Ave.	Akron, Ohio	1,688,000
Pittsburgh St.	Erie, Pa.	339,400
37th & Tuttle	Erie, Pa.	659,000

Ward and Peck St.	Erie, Pa.	666,000
Bridgeport St.	Worcester, Mass.	329,500
North St.	Worcester, Mass.	206,653
Providence Rd.	Worcester, Mass.	181,100
Hooper St.	Worcester, Mass.	506,377
Yale St.	Sanford, Maine	843,444

Reported net income before taxes of approximately \$4,350,000 was materially overstated by approximately \$3,005,000 as a result of the improper inclusion in sales of the foregoing projects. In addition, expenses were understated by approximately \$500,000 as a result of the improper omission of installation overrun expenditures from costs of sales.

(d) Fiscal Three Month Period Ending 10/31/70

The Homex consolidated financial statements for the fiscal quarter ended October 31, 1970, which reported modular sales of approximately \$4,800,000, materially overstated such sales as a result of the improper inclusion therein of the following projects:

<u>PROJECT</u>	<u>LOCATION</u>	<u>AMOUNTS</u>
Clay Phase I	Clay, N.Y.	\$2,821,200
Southbridge	Southbridge, Mass.	595,000
Ithaca I	Ithaca, N.Y.	333,200
Ithaca II	Ithaca, N.Y.	130,900
Grandview	Erie, Pa.	935,000

(e) Fiscal Five Months Period Ending 12/31/70

The Homex consolidated financial statements for the five months period ended December 31, 1970 which reported total sales of approximately \$10,500,000, materially overstated such sales as a result of the improper inclusion therein of the following projects:

<u>PROJECT</u>	<u>LOCATION</u>	A 319 <u>AMOUNTS</u>
Grandview	Erie, Pa.	\$ 935,000
Southbridge	Southbridge, Mass.	785,000
Progressive	Virgin Islands	4,197,500
Clay Development	Clay, N.Y.	2,380,400
57-31	Clay, N.Y.	2,100,000

(f) Fiscal Six Months Period Ending 1/31/71

The Homex consolidated financial statements for the six months period ended January 31, 1971, which reported total sales of approximately \$16,000,000, materially overstated such sales as a result of the improper inclusion therein of the following projects:

<u>PROJECT</u>	<u>LOCATION</u>	<u>AMOUNTS</u>
Hillwood Homes	Akron, Ohio	\$1,079,800
Ithaca	Ithaca, N.Y.	721,600
Washington	Washington, D.C.	721,600
Highland Ave.	Akron, Ohio	1,118,000
Grandview	Erie, Pa.	317,600
Greater Gulf	Mississippi	6,786,900
57-31	Clay, N.Y.	2,100,000

(g) Fiscal Seven and Nine Months Periods Ending 2/28/71 and 9/30/71

The Homex consolidated financial statements for the seven month period ended February 28, 1971 materially overstated all of the reported modular sales of approximately \$12,500,000 and \$3,723,000 of installation sales (out of total installation sales of approximately \$5,137,000) and for the nine months period ended April 30, 1971 materially overstated all of the reported modular sales of \$18,183,000 and \$4,656,000 of installation sales (out of total installation sales of approximately

1-3500
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\$5,866,000) as a result of the turnover inclusion of the following projects:

PROJECT	AMOUNTS IMPROPERLY INCLUDED IN			
	February 28, 1971		April 30, 1971	
	Modular Sales	Installation Sales	Modular Sales	Installation Sales
Ithaca, N.Y.	\$ 721,600		\$ 721,600	
Washington, D.C.	678,400		678,400	
Highland Ave.	1,118,000	546,000	1,118,000	546,000
Grandview Blvd.	317,600	190,000	317,600	293,000
Rochester, N.Y.	1,290,400		1,290,400	
Portland, Maine	552,200	214,000	553,600	257,000
Hillwood Homes	86,800	1,592,000	86,800	1,924,000
North St.		274,000		288,000
Providence Rd.		235,000		247,000
Pittsburgh Ave.		105,000		105,000
Bird and Pearl St.		649,000		649,000
Greater Gulf	7,916,000		7,866,00	
Virgin Islands			2,720,000	
A.I.T.			3,006,100	347,000
57-31	2,100,000		2,100,000	

The Homex consolidated statements of income for the seven month period ended February 28, 1971, and for the nine month period ended April 30, 1971, materially understated the cost of goods sold for the February 28, 1971, and April 30, 1971, periods by recording as accounts receivables approximately \$1,000,000 of excess costs incurred in performing the installation portion of certain Turnkey Projects.

The Homex consolidated statements of income for the seven month period ended February 28, 1971, and for the nine month period ended April 30, 1971, materially understated general, administrative and other expenses for the

February 28, 1971, and April 30, 1971, by improperly recording approximately \$32,800 of expenses as an asset (Property Plant and Equipment, under the subheading "Construction in Progress").

Reported consolidated net income before taxes of \$2,021,000 for the seven month period ended February 28, 1971 and net income before taxes of \$3,755,979 for the nine month period ended April 30, 1971 was materially overstated by \$4,986,414 for the February, 1971, period and \$7,329,902 for the April, 1971, period after taking into account only the matters just described.

In sum, while portraying Kortex as a company with increasing sales and earnings, the defendants omitted disclosing that most of such sales and the resulting and circulating accounts receivable were fabricated, that it had exhausted its bank lines of credit, invaded compensating balances, cut module production and payroll expenses and was, in early 1971, in the midst of a serious cash flow crisis.

(h) Fiscal Year Ending July 31, 1971

The Kortex consolidated financial statements for the twelve month period ended July 31, 1971, which reported total sales of approximately \$36,800,000, materially overstated such sales as a result of the improper inclusion therein of the following projects:

<u>PROJECT</u>	<u>LOCATION</u>	<u>AMOUNT</u>
Hillwood	Akron, Ohio	\$2,581,800
Highland	Akron, Ohio	1,664,000
Grandview	Erie, Pa.	502,500

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Ishtaca	Ishtaca, N.Y.	6,833,600
Stanley Simon	N.Y.	6,282,500
Morgantown	W. Va.	2,418,000
Clay	Clay, N.Y.	1,951,000
Greater Gulf	Mississippi	7,866,900
Virgin Islands	Virgin Islands	2,720,000
Rochester	Rochester, N.Y.	1,200,900

The consolidated statement of income for the fiscal year ended July 31, 1971 materially understated:

- (1) Cost of installation by recording as accounts receivable and other assets approximately \$2,000,000 of excess costs (cost overruns) incurred in performing the installation portion of certain HUD Turnkey Projects; and
- (2) General, administrative and other expenses by recording approximately \$1,000,000 of expenses improperly recorded by Homex as an asset (Property Plant and Equipment, under the sub-heading "Construction in Progress").

Reported income before taxes of \$6,630,663 for the fiscal year ended July 31, 1971 was overstated by approximately \$12,755,665 for said period.

(i) Fiscal Three Months Period Ending 10/31/71

The Homex consolidated financial statements for the three months ended 10/31/71, which reported revenues of approximately \$10,200,000, materially overstated such sales as a result of the improper inclusion therein of the following projects:

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PROJECT	LOCATION	AMOUNT
Greater Gulf	Mississippi	\$ 447,000
Stanley Simon	New York	5,362,000
Morgentown	West Virginia	173,000
Mallory Tonawanda	Tonawanda, N.Y.	1,968,000

(j) Fiscal Six Months Period Ending 1/31/72

The Homex consolidated financial statements for the six months ended 1/31/72, which reported revenues of approximately \$13,500,000, materially overstated such sales as a result of the improper inclusion therein of the following projects:

PROJECT	LOCATION	AMOUNT
Greater Gulf	Mississippi	\$ 915,000
Mallory Tonawanda	Tonawanda, N.Y.	2,097,000
Jamesstown, N.Y.	Jamesstown, N.Y.	442,000
Morgentown	Morgantown, W. Va.	173,000
Stanley Simon	New York	5,362,000

3. Some, but not all, of the additional parts or means by which the conspiracy and scheme to defraud was carried out were the following:

(a) In or about 1971, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, and HAROLD M. YANOWITZ, unlawfully, wilfully and knowingly caused the co-conspirator Salvatore J. Giovino to secretly intercept wire and oral communications of Richard G. Levering, then a Homex employee responsible for the dissemination of material corporate information to the financial media, for the purpose of preventing any disclosure of materially adverse corporate information.

(b) In or about 1971, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, and HAROLD M. YANOWITCH, caused the conspirator Salvatore J. Giovino to electronically "sweep" their homes and offices together with the home and office of Jack Saferstein, an official of Homex's largest customer, for the purpose preventing any disclosure of materially adverse corporate information.

(c) At all relevant times, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBLE L. PHILLIPS employed devices and techniques to suppress and conceal the truth including, for example, but not limited to: (1) the falsification and fabrication of records and documents; (2) the destruction of records and documents; (3) the use of cash in transactions where checks are normally employed; (4) the forgery of signatures; (5) the maintenance of more than one set of books of account for Homex and its subsidiaries; (6) the mass removal of records and documents upon the collapse and bankruptcy of Homex and its subsidiaries, etc.

(d) At all relevant times, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBLE L. PHILLIPS unlawfully, wilfully and knowingly paid and promised to pay things of value to public officials for the purpose of influencing official actions, including, for example, but not limited to, a \$10,000 payment to a United States Senator.

(e) At all relevant times, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBLE L. PHILLIPS, unlawfully, wilfully and knowingly, falsified information material to the SEC and

the performance of its official functions and lawful duties including, for example, but not limited to: (1) making false oral representations to representatives of the SEC; (2) making false written responses to questions posed in SEC letters of comment; (3) for the purpose of obstructing the post-bankruptcy investigations, giving false, evasive or perjurious answers to questions propounded while under oath; (4) making false and misleading statements in registration statements and periodic reports filed with the SEC; (5) deliberately omitting information required to have been filed or otherwise disclosed to the SEC; etc.

(f) At all relevant times, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, RUBLE L. PHILLIPS and EDWIN J. SCHULZ, unlawfully, wilfully and knowingly falsified information in Court proceedings including, for example, but not limited to, giving false, evasive or perjurious answers to questions propounded to them in the course of civil, bankruptcy and Grand Jury proceedings and ancillary interviews.

(g) At all relevant times, the defendants HAROLD M. YANOWITCH and RUBLE L. PHILLIPS, wilfully and knowingly falsified information in Federal Communication Commission ("FCC") proceedings including, for example, but not limited to, giving false and misleading statements in application papers filed with the FCC and giving false, evasive and perjurious answers to questions propounded in the course of administrative proceedings relating to said application.

4. On June 3, 1969, a deed was recorded in the Onondaga County Clerk's office, Deed Book 2404, p. 891 et

seq., from Hollyrood Park II, Inc., a New York corporation and a Homex subsidiary to Kece Associates, Ltd., a New York corporation, transferring several acres of land described as being a section of Farm Lot. No. 75, Belmont Village, Clay, New York. On June 25, 1969, a deed was recorded in the same clerk's office, Deed Book 2496, p. 761 et seq., transferring the same parcel from Kece Associates, Ltd. to Riverbend Estate, Inc. a New York corporation. At all relevant times, Peter Thun controlled Kece Associates, Ltd. and Riverbend Estate, Inc. The purchase price recited on copies of closing statements totaled \$325,000, all of which was then evidenced by various secured and unsecured notes (E.g. 703-710). A purchase money mortgage from Kece Associates, Ltd. to Hollyrood Park II, Inc., in the total sum of \$259,124. 00 was also recorded in the same clerk's office in Deed Book 2498, p. 459-963 on June 3, 1969. The aforementioned closing statements made no references to any representations by Homex or its subsidiaries to Peter Thun, Kece Associates, Ltd. or Riverbend Estates, Inc. and to any collateral relationships between the transfer of the land. For example, a "letter of intent" dated September 4, 1969, signed by the defendant Yanowitch on behalf of Kabeth Properties, Inc. and by Peter Thun on behalf of Riverbend Estates, Inc., describes a proposed future "contract for the design, manufacture and construction of 330 apartments." An apparently earlier, June 4, 1969, version of said letter of intent, addressed to Kece Associates, Ltd., was of the same tenor. Neither document was referred to in the closing statements; nor described or otherwise disclosed in the several Homex registration statements and exhibits thereto. Indeed, if the "agreement...to purchase modular housing" (GX 5, p.9) is

ment to refer to this letter of intent, then such constitutes a serious overstatement which would mislead and deceive the reader as to the true relationship between the parties. In any event, material aspects of the negotiations preceding the preparation and execution of the aforementioned deeds, notes, mortgages and letters, etc. were not included in said registration statements. Finally, material aspects of the negotiations following the execution of said documents and in consequence of the numerous defaults thereunder were likewise nowhere disclosed to the investing public.

On August 18, 1969, two deeds were recorded in the Onondaga County Clerk's office, Deed Book 2410, pp. 1101-1108, from Hollyrood Park II, Inc. and Elmsite Homes, Inc., both New York corporations and Homax subsidiaries, to Raseac Realty, Inc., a New York corporation transferring several acres of land described as being a portion of Farm Lot. No. 75 in the Town of Clay. Cesare Falcone, Morris J. Shapiro and Don J. Barbato controlled Raseac Associates, Inc. The purchase price recited on one copy of a closing statement, backdated to June 30, 1969, totaled \$425,000, only \$60,000 of which was then paid and \$365,000 being evidenced by various secured and unsecured notes (E.g. 704). A purchase money mortgage from Raseac Realty, Inc. to Hollyrood Park II, Inc. and Elmsite Homes, Inc. in the total sum of \$302,000 was also recorded in the same clerk's office on the same day, Deed Book 2413, pp. 5-8. The aforementioned closing statement made no reference to any representations by Homax or its subsidiaries to Cesare Falcone, Don J. Barbato and Morris J. Shapiro and to any collateral relationships between

such persons and the transfer of the land. For example, an assignment to Raseac Realty, Inc., dated July 31, 1969, signed by the defendant Yanowitch on behalf of Hollywood Park II, Inc., describes an option granted to the Gulf Oil Corporation which committed the latter to an exercise payment of \$100,000 for a small portion of the property transferred to Raseac. Neither the assignment nor the underlying option was referred to in the closing statement or otherwise disclosed in the several Homex registration statements and exhibits thereto. Similarly, material aspects of the negotiations preceding the preparation and execution of the aforementioned deeds, notes, mortgages and assignments, etc., were not included in said registration statements. Material aspects of the negotiations following the execution of the said documents and in consequence of the numerous defaults thereunder were likewise nowhere disclosed to the investing public. For example, the 1971 transfer of ownership of Raseac Realty, Inc. to Bernard A. Frank and John Garrity, the defendant YANOWITCH's former law partners, and the attendant promise of increased legal fees to cover their costs was nowhere disclosed.

5. The defendant DAVID STIRLING, JR. signed, purportedly on behalf of Kabeth Properties, Inc., a Homex subsidiary, a document reciting an "Agreement this 23rd day of December 1970" with Route 57 & 31 Development Corp. to sell to it several acres of property in Clay, New York, which was signed on its behalf by one Carmen Grasso, as its President. Thereafter, and also purportedly on behalf of Kabeth Properties, Inc., Ruben K. Davis signed a retyped

version of said document which was later filed with the SEC as part of GX 9 at pp. 43121 et seq. This document recited a "purchase price" of \$2,100,000. Harold Wynn and William J. Grogg, Jr. controlled the Empire Pipeline Co., a business the income of which in material part had been derived or received from Hemex and its affiliates, and, together with Carmine Grasso, controlled Route 57 & 31 Development Corp. The purchase price recited in both of the aforementioned documents totaled \$2,100,000, of which \$210,000 was said to be payable on December 30, 1970 and the balance of \$1,890,000 five years later on December 30, 1975. On or about that date, the sum of \$210,000 was paid from the proceeds of a \$250,000 loan by the First National Bank of Rochester to the Route 57 & 31 Development Corporation. In addition to the borrower's note, the loan was further secured and collateralized by the individual guarantees of Grasso, Grogg and Wynn and by a letter assignment, dated December 30, 1970, and signed by R.K. Davis on behalf of Kabeth Properties, Inc., of the net proceeds of a condemnation award then being prosecuted by Kabeth against the State of New York. Nowhere were these financing circumstances disclosed to the investor. Copies of two additional documents were also filed with the commission as part of GX 9 at pp. 43146-43157; each bearing the purported signatures of R.K. Davis on behalf of Kabeth Properties, Inc. and Messrs. Grasso and Wynn. Material aspects of the discussions preceeding and following the execution of the aforementioned documents were nowhere disclosed to the investing public.

6. On and after the week beginning February 23, 1971, the defendant PHILLIPS procured Kenneth N. Caron's

signature on behalf of a Mississippi non-profit corporation named the Greater Gulf Coast Housing Development Corporation ("Greater Gulf"), and thereafter the defendant HAROLD M. YANOWITZ's signature on behalf of Homex on a document purporting to have sold on "this 28th day of December, 1970" approximately 800 dwelling units for \$15,000,000. On or about the same time, the defendant PHILLIPS procured the signatures of the same individuals on an additional document purporting to have sold on "this 23rd day of December, 1970," approximately 5,000 dwelling units for \$100,000,000. On or about March 8, 1971, the defendant PHILLIPS signed, on behalf of Homex, a letter to Greater Gulf falsely reciting a December 23, 1970, execution of the aforementioned document and falsely claiming an inadvertent failure to relate the terms thereof to the document purporting to sell approximately 5,000 dwelling units for \$100,000,000 or to have included a provision requiring that the 800 units be manufactured in Harrison County, Mississippi. On or about March 16, 1971, the defendant PHILLIPS signed a letter to Greater Gulf purporting to commit Homex to several additional promises beyond those previously set forth. On or about March 18, 1971, the defendant PHILLIPS procured Kenneth H. Caron's signature on a document purporting to accept with attachments a \$15,000,000 loan from U.S. Shelter Corporation, a Homex subsidiary, and purportedly ratifying the aforementioned PHILLIPS misrepresentations. In or about this same time period, the defendant PHILLIPS procured Kenneth H. Caron's signature on a document accepting a purported \$15,000,000 loan commitment from the Farmers Home

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Administration of the United States Department of Agriculture which in truth and in fact, was a forgery and, which on or about March 19, 1971, the defendant TARDITCH displayed to Romex's auditors. On or about May 26, 1971, the defendant PHILLIPS signed and procured the signature of another on an exchange of letters for the purpose of defrauding an unidentified governmental official into withdrawing objections to the matter dealt with in said letters. Some of the aforementioned documents was made part of Romex's registration statement as an exhibit thereto. More fundamentally, too little of the truth concerning this matter was set forth in any of the successive editions of Romex's registration statements, its periodic reports or its public announcements. Additionally, material aspects of the discussions preceding and following the execution of the aforementioned documents were nowhere disclosed to the investing public.

7. The defendants disseminated fraudulent financial information by filing GX 1 through 29, by the distribution of press releases to the media and by the direct distribution of false data to banks, brokers, etc.

8. The seven officials of the United Brotherhood of Carpenters and Joiners of America and its locals were: S. Ruggiano; R.E. Livingston; P.J. Campbell; W. Konyha; E.E. Jacobs, Jr.; M. March; and J.J. Catalfano. The shares were purchased in or about the spring of 1970 and sold at various times, beginning in the fall of 1970, thereafter through the agencies of individuals too numerous to identify.

9. Each of the defendants used the mails, telephones, telegrams and other interstate communications

and travel facilities and instrumentalities in carrying out his respective part of the scheme and conspiracy.

10. The registration statement referred to is SEC registration number 2-40122 which became effective on July 29, 1971. It was originally filed on April 21, 1971, as GX 8 together with GX 9, its exhibits. Amendments one through three were filed, with exhibits on May 28, 1971, July 16, 1971 and July 29, 1971, respectively, as GX 10 through GX 12. It failed to properly and truthfully appraise the reader of Homex's business and financial condition with respect to the matters alleged in Count One of the Indictment and, in addition, the matters set forth in paragraphs 1 through 9 of this Bill of Particulars.

11. The "departments and agencies of the United States" include the SEC, the IRS, HUD, the Department of Labor and the agency employing the unidentified official referred to in paragraph 6 of this Bill of Particulars. The gravamen of the conspiracy charge is a conspiracy to commit the substantive offenses charged in the first Eight Counts of the Indictment. In addition to SEC registration statement 2-40122, the defendants also falsified SEC registration statement 2-34949 which was filed on October 1, 1969 (GX 1 and 3) and amended on February 17, 1970 (GX 4), February 19, 1970 (GX 5), July 16, 1971 (GX 6) and August 23, 1971 (GX 7). The Homex annual, quarterly, monthly reports and proxy statements filed with the SEC and alleged to have been deliberately falsified are marked as GX 13 through GX 29. This registration statement and each of these additional reports failed to properly and truthfully appraise the reader of Homex's business and financial condition with

respect to the matters alleged in Count One of the Indictment, and, in addition, the matters set forth in paragraphs 1 through 9 of this Bill of Particulars.

Dated: New York, New York

September 29, 1976

Yours, etc.

ROBERT B. FISKE, JR.
United States Attorney for the
Southern District of New York
Attorney for the United States
of America

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EXHIBIT 5

**Original Complaint in *Jezarian v. Csapo*,
U.S.D.C., S.D.N.Y., 72 Civ. 1671 (DBB)**

(Reproduced herein as pages A335 to A344)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
GREGORY JEZARIAN and GERALDINE JEZARIAN,

Plaintiffs,

COMPLAINT --
CLASS ACTION

- against -

FRANK CSAPO, E. A. BARTZ, C. W. MARSHALL,
EDWIN J. SCHULZ, HARPER SIBLEY, JR.,
DAVID STIRLING, JR., WILLIAM G. STIRLING,
CARL L. WREN, STIRLING HOMEX CORPORATION
and PEAT, MARWICK, MITCHELL & CO.,

PLAINTIFFS DEMAND
TRIAL BY JURY

Defendants.
-----X

Plaintiffs, by their attorneys, Pomerantz Levy Haudek
& Block, complaining of defendants, allege upon information and
belief, except as to ¶ 6 which is alleged upon knowledge:

1. (a) The jurisdiction of the Court is based on
§ 27 of the Securities Exchange Act of 1934 (the "Exchange Act")
15 U.S.C. § 78aa, as amended.

(b) The claims alleged herein arise under the
Exchange Act, and the rules and regulations of the Securities
and Exchange Commission promulgated thereunder.

(c) The illegal acts complained of herein
occurred in substantial part in the Southern District of New
York.

2. Class Action Allegations

(a) A Class action is alleged pursuant to Rule 23(b)(3) F.R.C.P.

(b) The class consists of all persons who purchased securities of Stirling Homex Corporation (the "Corporation") between March 16, 1971 and March 20, 1972 during which period the price of said stock was artificially inflated because of fraudulent misrepresentations, as more fully alleged hereafter. During this time the Corporation had, and still has, approximately 8,900,000 shares of common stock outstanding. Additionally, the Corporation has had, since about July 29, 1971, approximately 500,000 shares of \$2.40 convertible preferred stock outstanding. The Corporation's common stock and preferred stock are widely held by many thousands of shareholders throughout the country. The class consists of many thousands of persons damaged by defendants' false statements.

(c) Plaintiffs are members of said class; their claims are typical of the claims of all class members. They and their counsel will fairly and adequately protect the interests of the class.

(d) The questions of law and fact common to the class are: the duty owed by defendants to members of the class; their resulting liabilities; the measure of damages; the dissemination and falsity of the challenged statements, their materiality and market impact.

(e) The questions of law and fact common to the members of the class predominate over any questions affecting individual members.

(f) A class action is superior to other available methods for the fair and efficient adjudication of the controversy.

3. (a) The Corporation, a Delaware corporation, is authorized to do business in New York and has an office at 437 Madison Avenue, in the City, County and State of New York.

(b) The Corporation is engaged in the business of manufacturing, selling and installing modular housing units.

4. At the times of the transactions complained of:

(a) Defendant Csapo was a vice president of the Corporation;

(b) Defendant Bartz was a vice president and the secretary of the Corporation;

(c) Defendant Marshall was a director of the Corporation;

(d) Defendant Schulz was a senior vice president of the Corporation;

(e) Defendant Sibley was a beneficial owner of more than 10% of the Corporation's common stock;

(f) Defendant David Stirling, Jr. was the chairman of the Corporation's board of directors and its chief executive officer;

(g) Defendant William G. Stirling was a director of the Corporation, and its president and chief operating officer;

(h) Defendant Wren was a vice president of the Corporation.

5. Defendant Peat, Marwick, Mitchell & Co., ("Peat Marwick") a partnership, was and is a firm of certified public accountants with an office in the Southern District of New York. At all times mentioned herein, it served as the Corporation's independent certified public accountants and auditors.

6. Plaintiffs purchased 50 shares of the Corporation's common stock on March 22, 1971, and 25 shares on October 1, 1971.

7. Between March 16, 1971 and March 20, 1972, the Corporation repeatedly issued financial statements and other reports which materially overstated the Corporation's revenues, profits, assets and stockholders' equity and understated reserves and liabilities in the following respects, among others:

(a) Improperly including in sales and receivables certain transactions involving modular dwelling units, although the criteria which would permit the recognition of such transactions as sales and receivables had not been met;

(b) Improperly including in sales and receivables installation work on the percentage of completion method;

(c) Deferring rather than expensing research and development expenditures, project and production start-up costs and other expenditures;

(d) Failing to set up adequate reserves and provisions for allowances for doubtful accounts and other losses;

(e) Including in sales and receivables a sale of a parcel of land for \$2,100,000 which was not in fact a true sale.

8. (a) The false figures referred to in paragraphs 7(a)-(d) were reported or reflected in the following reports or releases issued by the Corporation or filed by it with the Securities and Exchange Commission:

(i) A financial report for the period ended January 31, 1971, contained in a press release issued on or about March 17, 1971;

(ii) A form 10-Q report for the six months ended January 31, 1971;

(iii) The Corporation's preliminary prospectus dated April 21, 1971, which included financial statements for the seven months ended February 28, 1971;

(iv) A financial report for the period ended April 30, 1971, contained in a press release issued on or about May 20, 1971.

(v) A form 10-Q report for the nine months ended April 30, 1971;

(vi) A final prospectus dated July 29, 1971, which included: (I) financial statements for the seven months ended February 28, 1971 and; (II) financial statements for the nine months ended April 30, 1971;

(vii) A financial report for the fiscal year ended July 31, 1971, which was contained in a press release issued on or about September 15, 1971;

(viii) The Corporation's 1971 Annual Report to shareholders which contained financial statements for the fiscal year ended July 31, 1971;

(ix) A form 10-K report for the fiscal year ended July 31, 1971;

(x) A form 10-Q report for the three months ended October 31, 1971;

(xi) A financial report for the three months ended October 31, 1971 contained in a press release issued on or about December 7, 1971.

(b) The false figures referred to in ¶ 7(e) were reported or reflected in the financial reports or releases described in ¶ 8(a)(i)-(v).

9. The financial statements or reports described in ¶ 8(a)(iii), (vi)(I), (vii), (viii), (ix) were certified by Peat Marwick.

10. The Corporation sent the reports and the releases referred to in ¶ 8(a) to its security holders and to the press, brokers and dealers, research organizations and financial institutions.

11. The reports and releases described in ¶ 8(a) were disseminated in interstate commerce and by the use of the mails and were false and misleading in that they contained untrue statements of material facts and omitted to state material facts necessary in order to make the statements made in light of the circumstances in which they were made not misleading.

12. (a) The reports or releases described in ¶ 8(a)(vii), (viii) and (ix) reported the Corporation's net income before taxes for the fiscal year ended July 31, 1971 as \$6,630,663;

(b) The reports or releases described in ¶ 8(a)(x) and (xi) reported the Corporation's net income before taxes for the three months ended October 3, 1971 as \$1,806,305;

(c) For the three months ended January 31, 1972, the Corporation reported a dramatic change in its operating results in that it reported for that period a net loss before taxes of \$4,362,789.

13. Although the Corporation did not publicize until on or about March 20, 1972 a net loss before taxes of over \$4,000,000 for the three months ended January 31, 1972, it was apparent to the defendants by reason of their fiduciary positions with the Corporation at least as early as September 1, 1971, that the Corporation's earnings would change as drastically as they did.

14. The Corporation's aforesaid net loss of over \$4,000,000 for the three months ended January 31, 1972, was attributable to, among other things:

(a) The failure of certain transactions involving modular homes to meet the criteria which would permit their recognition as sales;

(b) The significant increase in manufacturing, administrative and selling overhead as a result of the Corporation's developing new markets;

(c) The establishment of substantial allowances for doubtful accounts;

(d) The substantial increase in installation division costs due to engineering and other difficulties.

15. Using the non-public information acquired by them solely by virtue of their fiduciary positions with the Corporation, and in order to reap large profits for themselves before the Corporation announced to the public its dramatic change in its operating results, the individual defendants sold shares of the Corporation's commonstock which they owned. During the period September 1, 1971 to March 20, 1972, defendant Sibley sold at least 250,000 shares; defendant David Stirling, Jr. sold at least 41,900 shares; defendant William G. Stirling sold at least 41,900 shares; defendant Bartz sold at least 7,500 shares; defendant Csapo sold at least 20,000 shares; defendant Marshall sold at least 5,000 shares; defendant Schulz sold at least 3,000 shares and defendant Wren sold at least 5,000 shares.

16. The aforesaid 374,300 shares of the Corporation's common stock were sold by the individual defendants at an average price of \$18.00 per share.

17. Upon revelation to the public on March 20, 1972 of the enormous financial loss suffered by the Corporation, the market price of its common stock dropped sharply to approximately \$10 per share and shortly thereafter went below \$6 per share.

18. Were it not for the failure of defendants to reveal the information stated in ¶¶ 7 and 14 which was known to them, plaintiffs, and other members of the class, would have been able to purchase their shares at substantially lower prices than those prevailing at the time of their purchases.

19. Defendants knew or should have known of the falsity of the figures, reports and releases described in ¶ 8(a).

20. As a result of the dissemination of the false and misleading reports and releases described in ¶ 8(a), and the failure of defendants to make publicly known the confidential information which they took advantage of while selling their securities, the market price of the Corporation's securities was artificially inflated during the period between March 16, 1971 and March 20, 1972. In ignorance of the falsity of the reports and releases described in ¶ 8(a), plaintiffs and other members of the class relied on the integrity of the market prices during said period in purchasing their shares.

21. Plaintiffs and members of the class have suffered substantial injury as a result of the wrongs herein complained of.

WHEREFORE, plaintiffs pray for judgment:

(a) Awarding plaintiffs and all members of the class damages for the wrongs herein complained of;

(b) Awarding plaintiffs the costs and expenses of the litigation, including reasonable counsel and accounting fees; and

(c) Granting such other and further relief as may be just.

Dated: New York, New York
April 24, 1972

Pomerantz Levy Haudak & Block

By

A. L. Pomerantz

A Member of the Firm
Attorneys for Defendants
295 Madison Avenue
New York, New York 10017
(212) 532-4800

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EXHIBIT 6

Stirling Homex Prospectus Dated July 29, 1971

(Reproduced herein as pages A346 to A387)

PROSPECTUS

500,000 Shares

Stirling Homex Corporation

\$2.40 Cumulative Convertible Preferred Stock

(Par Value \$1 Per Share)

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Convertible (unless previously called for redemption) into Common Stock at $14\frac{1}{2}$ per share, subject to adjustment in certain events. Redeemable at any time as a whole or in part at the option of the Company, upon not less than 30 days' notice, at redemption prices shown herein beginning at \$50 and declining to \$40 after August 1, 1981, plus, in each case, accrued dividends.

The Common Stock is traded in the over-the-counter market. The closing bid and asked prices of the Common Stock in such market (as reported by the National Association of Securities Dealers' Automatic Quotations) for July 28, 1971 were 14 and $14\frac{1}{2}$ per share.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public(1)	Underwriting Discount(2)	Proceeds to Company(3)
Per Share	\$40.00	\$2.00	\$38.00
Total	\$20,000,000	\$1,000,000	\$19,000,000

(1) Plus accrued dividends, if any, from date of delivery of the Preferred Stock to the Underwriters. Dividends will accrue from such date of delivery and the first dividend will be payable by the Company on October 31, 1971 and thereafter quarterly.

(2) The Company has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933.

(3) Before deducting expenses payable by the Company estimated at \$225,000.

The Preferred Stock is offered by the several Underwriters subject to prior sale, when, as and if issued to and accepted by such Underwriters, and subject to approval of certain legal matters by their counsel, Messrs. Brown, Wood, Fuller, Caldwell & Ivey, and by counsel for the Company, Messrs. Shea Gould Climenko & Kramer, and to certain other conditions. The Underwriters reserve the right to withdraw, cancel or modify such offer and to reject orders in whole or in part.

Merrill Lynch, Pierce, Fenner & Smith
Incorporated

July 29, 1971

No dealer, salesman or any other person has been authorized by the Company or the Underwriters to give any information or make any representations other than those contained in this Prospectus, and if given or made, such information or representations must not be relied upon. This Prospectus does not constitute an offer to sell nor the solicitation of an offer to buy any of the securities offered hereby in any jurisdiction to any person to whom it is unlawful to make such offer in such jurisdiction. Except where otherwise indicated, this Prospectus speaks as of its date. Neither the delivery hereof nor any sale made hereunder shall create an implication that the affairs of the Company have continued without change since such date.

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE PREFERRED STOCK AND COMMON STOCK OF THE COMPANY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

THE COMPANY

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Stirling Homex Corporation manufactures modular housing units and believes that it is one of the nation's leading producers of multi-family modular housing. The modules are manufactured on an assembly-line, using conventional building materials, and are combined at the housing site to form completed dwelling units. Substantially all sales to date have been of two story, attached, wood frame townhouses. The Company has designed a concrete and steel frame module for use in high-rise buildings and has been selected by two housing authorities and the Department of Housing and Urban Development ("HUD") to build four high-rise buildings utilizing the concrete and steel frame modules.

All of the Company's sales of dwelling units for the year and nine months ended April 30, 1971 and substantially all of its backlog represent sales to and orders from local housing authorities, non-profit sponsors and a private university for federally assisted housing projects. Generally, upon receipt of a commitment from a customer, the Company purchases the land, prepares the site, lays the foundations, arranges utility connections, manufactures, installs and connects the modules, and landscapes the housing site, thereby providing a total service to the customer in delivering turnkey housing. Modules are equipped in the manufacturing process with the necessary plumbing and heating fixtures, electrical wiring, appliances, and floor and wall coverings.

Stirling Homex Corporation (with its subsidiaries the "Company") was incorporated in Delaware in 1968. Its principal plant and executive offices are at 1150 East River Road, Avon, New York 14414, telephone 716-926-2481.

PURPOSE OF THE ISSUE

The net proceeds to the Company from the sale of its shares offered hereby (approximately \$18,775,000) will be added to the general funds of the Company and will be available for working capital. The working capital requirements of the Company are substantial and have increased as a result of the growth in sales volume and other factors. See "Business—Sales". Additional working capital will be required in connection with the operation of the proposed new plant in Gulfport, Mississippi. See "Properties—Mississippi Plant". Additions to plant, property and equipment aggregated more than \$8,500,000 during the year and nine months ended April 30, 1971.

As of June 30, 1971, the Company had outstanding \$37,450,000 of short-term indebtedness to banks which had been incurred for working capital purposes. The Company estimates that substantially all the net proceeds from the sale of its shares offered hereby will be applied initially to the temporary reduction of such indebtedness. The Company intends to continue to make short-term borrowings from banks in substantial amounts for working capital purposes. See "Business—Sales".

CAPITALIZATION

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The following table sets forth the capitalization of the Company as of April 30, 1971 and the adjusted amounts giving effect to the issue and sale of the shares of Preferred Stock offered hereby.

Debt:	Outstanding	As Adjusted
Short term-notes payable to banks(1)	\$33,700,000	\$14,700,000
Long term-sundry indebtedness(2)	628,027	628,027
Total Debt	<u>\$34,328,027</u>	<u>\$15,328,027</u>
Stockholders' Equity:		
Preferred Stock, par value \$1 per share:		
Authorized 500,000 shares; no shares outstanding; as adjusted		
500,000 shares (liquidation value \$20,000,000)	—	500,000
Common Stock, par value \$.01 per share:		
Authorized 15,000,000 shares; outstanding 8,909,000 shares(3)	89,090	89,090
Additional paid-in capital	8,481,422	26,981,422
Retained earnings	4,948,883	4,948,883
Less treasury stock (60,000 shares)	(180,750)	(180,750)
Total Stockholders' Equity	<u>\$13,338,645</u>	<u>\$32,338,645</u>

(1) Notes payable consist of 90 day unsecured notes to eleven banks bearing interest at a rate $\frac{1}{8}\%$ above the respective bank's best rate on the date of issue. The Company is required to maintain average annual compensating balances at each of these banks equal to approximately 15% to 20% of the outstanding indebtedness to such bank. See "Business—Sales".

(2) See Note 8 of Notes to Consolidated Financial Statements.

(3) Does not include 888,400 shares reserved for issuance upon the exercise of stock options granted or that may be granted under the Stock Option Plan (see "Stock Option Plan") and 1,79,310 shares reserved for issuance upon conversion of the Preferred Stock (see "Description of Capital Stock—Preferred Stock Conversion Rights").

For information concerning obligations under leases on real property, see "Properties—Mississippi Plant" and Note 11 of Notes to Consolidated Financial Statements. For information concerning indebtedness of U. S. Shelter Corporation, see Note 1 of Notes to Consolidated Financial Statements and "Business—Sales".

PRICE RANGE OF COMMON STOCK

The Company's Common Stock is traded in the over-the-counter market. The following table sets forth the range of high bid prices for the Common Stock since its initial public offering on February 19, 1970 at \$16.50 per share, as reported by the National Quotation Bureau, Incorporated. The prices represent prices between dealers, not including any retail mark-up, mark-down or commission, and do not necessarily represent actual transactions.

	High	Low
1970		
1st Quarter (from February 19)	51 $\frac{1}{2}$	26
2nd Quarter	49 $\frac{3}{4}$	8 $\frac{3}{4}$
3rd Quarter	27 $\frac{3}{4}$	11 $\frac{1}{4}$
4th Quarter	25 $\frac{1}{4}$	16
1971		
1st Quarter	26 $\frac{5}{8}$	18
2nd Quarter	23 $\frac{1}{4}$	17 $\frac{3}{8}$
3rd Quarter (through July 28)	18 $\frac{7}{8}$	14

The closing bid and asked prices of the Common Stock in the over-the-counter market (as reported by the National Association of Securities Dealers' Automatic Quotations) for July 28, 1971 were 14 and 14 $\frac{1}{2}$ per share.

DIVIDENDS ON COMMON STOCK

The Company has never declared or paid cash dividends on its Common Stock. All earnings are reinvested in the business. It is not the present intention of the Board of Directors to declare or pay any cash dividends on Common Stock for the foreseeable future. For information with respect to limitations on dividends on Common Stock, see "Description of Capital Stock—Dividend Rights and Restrictions".

CONSOLIDATED STATEMENT OF INCOME

The following Consolidated Statement of Income of Stirling Homex Corporation and consolidated subsidiaries has been examined as to the two years ended July 31, 1970 by Harris, Kerr, Forster & Company, independent certified public accountants, as set forth in their report appearing elsewhere in this Prospectus. It should be read in conjunction with the other financial statements (including the financial statements examined by Peat, Marwick, Mitchell & Co., independent certified public accountants as set forth in their report appearing elsewhere in this Prospectus) and the related notes included in this Prospectus. With respect to the figures for the nine month periods ended April 30, 1970 and 1971 which are unaudited, the management of the Company believes that all adjustments (none of which were other than normal recurring accruals) necessary to a fair statement of the results for such interim periods have been included.

	Year Ended		Nine Months Ended	
	July 31, 1969	July 31, 1970	April 30, 1970 (Unaudited)	April 30, 1971 (B) (Unaudited)
Revenues:				
Sales—trade (A):				
Manufacturing division	\$2,961,181	\$16,492,770	\$10,855,020	\$18,183,170
Installation division	537,532	5,601,357	3,670,277	6,386,388
Sales to affiliates (A) (D):				
Manufacturing division	2,445,022	—	—	—
Installation division	3,695,316	459,941	459,941	—
Equity in undistributed net income of finance subsidiary (Note 1)	—	—	—	84,434
Total revenues	<u>\$9,639,051</u>	<u>\$22,554,068</u>	<u>\$14,985,238</u>	<u>\$24,653,992</u>
Costs and Expenses:				
Cost of sales (A):				
Manufacturing division	\$2,992,682	\$ 9,919,327	\$ 5,968,419	\$11,414,275
Installation division	3,897,213	5,240,388	3,519,230	5,863,586
Administrative and selling expenses ..	701,157	2,390,604	1,623,365	2,311,343
Interest—long term debt	48,420	9,165	8,786	21,343
—other	26,342	639,016	430,522	1,287,466
Total costs and expenses	<u>\$7,665,814</u>	<u>\$18,198,500</u>	<u>\$11,550,322</u>	<u>\$20,898,013</u>
	<u>\$1,973,237</u>	<u>\$ 4,355,568</u>	<u>\$ 3,434,916</u>	<u>\$ 3,755,979</u>
Other income:				
Sales of land (Notes 4 and 5)	\$ 425,956	—	—	—
Income before Federal and state income taxes	<u>\$2,399,193</u>	<u>\$ 4,355,568</u>	<u>\$ 3,434,916</u>	<u>\$ 3,755,979</u>
Income taxes (Note 9):				
Federal—current	\$ 730,554	\$ 1,757,513	\$ 1,423,465	\$ 826,754
—deferred	422,343	317,386	265,714	785,406
State—current	112,658	208,469	170,816	171,676
—deferred	51,157	37,011	37,959	140,930
	<u>\$1,316,712</u>	<u>\$ 2,320,379</u>	<u>\$ 1,897,954</u>	<u>\$ 1,924,766</u>
Net income	<u>\$1,082,481</u>	<u>\$ 2,035,189</u>	<u>\$ 1,536,962</u>	<u>\$ 1,831,213</u>
Average shares outstanding (C)	<u>8,025,432</u>	<u>8,649,483</u>	<u>8,566,844</u>	<u>8,891,760</u>
Earnings per common share (C) (July 31, 1969 includes \$.02 per share from sales of land)	<u>\$.13</u>	<u>\$.24</u>	<u>\$.18</u>	<u>\$.21</u>

NOTES:

(A) Sales of modules (Manufacturing Division) are recognized when units are manufactured and assigned to specific contracts. Installation work (Installation Division) is recorded on the percentage of completion method. See Note 3 of Notes to Consolidated Financial Statements and "Business—Sales" for additional information.

(B) The results for the nine months ended April 30, 1971 should not necessarily be considered indicative of the results for the year ending July 31, 1971.

(C) Earnings per common share are based upon the weighted average number of shares outstanding during the periods presented after giving retroactive effect to the four-for-one stock split effected in February 1970. Stock options outstanding during these periods have not been included in this computation since the effect of their inclusion would be insignificant.

(D) Gross profit on sales to affiliates was \$510,233 for the year ended July 31, 1969 and \$59,833 for the year ended July 31, 1970.

(E) The following expenses relating to land held for development or sale were capitalized in the periods presented:

	Year Ended		Nine Months Ended	Nine Months Ended
	July 31, 1969	July 31, 1970	April 30, 1970	April 30, 1971
Real estate taxes	\$ 18,452	\$23,762	\$23,762	\$43,648
Mortgage interest	93,974	38,774	30,139	19,726
Other expenses	55,558	33,133	36,220	147
	<u>\$167,984</u>	<u>\$95,669</u>	<u>\$90,121</u>	<u>\$63,521</u>

(F) The pro forma (unaudited) ratio of earnings before fixed charges (which are comprised of interest and one-third of rentals) and taxes on income to fixed charges and earnings required for preferred stock dividends is 1.8 for the year ended July 31, 1970, and 2.3 for the nine months ended April 30, 1971. Earnings required for annual preferred stock dividends of \$1,200,000 would have been approximately \$2,614,000 for the year ended July 31, 1970, and \$1,841,000 for the nine months ended April 30, 1971, before deducting applicable income taxes.

(G) No dividends have been declared or paid during the periods covered by the above statements.

(H) Numerical note references are to Notes to Consolidated Financial Statements.

Sales and net income for the months of March and April 1971 were substantially higher, on a monthly basis, than sales and net income for the seven months prior thereto. This was due primarily to increased production resulting from the completion in late January of additions to the Company's manufacturing facility in Avon and higher costs and lower production during the earlier period by reason of the construction of such additions, the accomplishment of certain product design changes and the temporary cessation of production for ten days in August 1970. The Company can give no assurance that the levels of sales and net income experienced during March and April 1971 can be maintained.

The unamortized balance of deferred charges increased by approximately \$1,600,000 during the nine months ended April 30, 1971. Such increase principally represents the deferral of certain costs incurred in connection with the continuing development of the Company's high-rise apartment system, low-rise townhouses and apartment/hotel units, installation and start-up of computer systems, the aforementioned plant start-up costs for the Company's new manufacturing facility in Avon, applications for U. S. and foreign patents and trademarks, and costs attributable to the issuance of the Preferred Stock offered hereby. These additions to deferred charges, other than costs attributable to the issuance of the Preferred Stock offered hereby, represent approximately 39% of income before Federal and state income taxes for the nine months ended April 30, 1971. See Note 7 of Notes to Financial Statements.

The Company is engaged in the assembly-line manufacture and sale of modular housing units. The Company manufactures modules for two story wood frame townhouses and apartments, and has developed concrete and steel frame modules for high-rise structures. Substantially all of the dwelling units sold have been purchased by customers for rental rather than resale.

Products

The Townhouse

The townhouse consists of two, three or four modules, varying with the number of bedrooms. Modules are approximately 12 feet in width, up to 31 feet in length and 9 feet in height and are stacked and joined to form two story dwellings. All modules, upon leaving the assembly-line, contain and have affixed or installed wall and floor coverings, wood trim, drapery fixtures, cabinetry, stairs, heating and plumbing fixtures, all necessary electrical systems and fixtures, and welded insulated glass windows. If ordered, a stove, refrigerator and air conditioning system are included. The exterior walls are insulated, sheathed and finished except where conventional brick is used, which is applied at the site.

To date, substantially all of the Company's sales of dwelling units have been of two story attached townhouses. Studio, one, two, three, four and five bedroom models are now available, with a variety of exterior treatments. When the modules have been joined and utilities connected at the building site, nothing further is required to prepare the dwelling units for occupancy. The Company may adjust its production line to meet the specifications of a substantial order. Dwelling units vary in price to the Company's customers from \$15,000 for a studio unit to \$26,000 for a five bedroom unit, inclusive of average site work, installation and transportation costs, and exclusive of land costs.

The Company performs the on-site development work and the installation of the modules in a conventional manner. It utilizes independent contractors and local union construction personnel and tradesmen under the supervision of the Company's employees. Primary on-site development work consists of preparing the foundations, making the necessary utility connections, and installing sewers. Townhouse modules are transported to the site by truck or rail, lifted by crane onto the foundations and joined to each other and the foundation. The electrical, heating and plumbing systems between the modules are connected, and pre-packaged trim is applied where the modules are joined. Gutters and downspouts are then installed and brick is applied to the first floor exterior when required by the customer. Finally, the appropriate areas of the site are landscaped and paved.

The High-Rise

The Company has designed a concrete and steel frame module for use in high-rise buildings up to twenty stories in height. It has been selected by two housing authorities and, subject to entering into contracts, will build three high-rise apartment buildings (twelve and thirteen stories) using these modules. See also "Business—Operation Breakthrough". The modules that will become the top floor of the building are placed on the building foundation which has electronically controlled hydraulic jacks and supporting steel structures in alternate bays. After those modules are connected to each other, the jacks raise the entire floor 10 feet and new modules are inserted in the alternate bays below. The jacks are then lowered and the other bays are filled with modules to complete the floor, which is then elevated. This process is repeated until the building is completely erected. The high-rise buildings will contain elevators. Non-load bearing interior walls may be placed wherever desired, thus permitting flexibility of design.

The Company has built a four story building using this system adjacent to its Avon plant. This building is used both as a sales facility and to train Company employees in the use of its high-rise

installation system. Patent applications are pending with respect to the Company's concrete and steel frame module and its system for erecting a high-rise building, but no assurance can be given that patents will be granted.

Operation Breakthrough

The Company's high-rise system has been selected by HUD as one of twenty-two winners in its "Operation Breakthrough" program. As part of Operation Breakthrough, the Company has entered into an agreement to construct a 13-story building containing more than 200 apartments for the elderly in Memphis, Tennessee. This program has as its goal the development of new technology and greater production capacity in the housing industry to assist in meeting the continuing high demand for housing in the United States.

Sales

Total revenues for the year ended July 31, 1970, and for the nine months ended April 30, 1971, were \$22,554,068 and \$24,653,992. The trade sales for the respective periods were to nine customers and 26 customers. For the year ended July 31, 1970, the largest customer accounted for approximately 58% and for the nine months ended April 30, 1971, no customer accounted for more than 14% of sales. One customer was the assignor of a single contract which would have accounted for about 32% of sales for the nine month period if it had not been assigned in part. The assignor agreed to purchase 800 dwelling units from the Company. Thereafter, the obligation to purchase these dwelling units was assigned in part to 12 other customers without recourse to the assignor. These assignments have no effect on the Company's method of recognizing and recording income. No other customer accounted for as much as 14% of sales for either period. Because of the nature of the Company's business, the identity of its customers is likely to differ from year to year. The Company therefore believes that the percentage of sales represented by any single customer in a particular year is not necessarily indicative of the importance of such customer to the on-going business of the Company.

Of the sales for the nine months ended April 30, 1971, about 19%, including a substantial part of those made pursuant to the contract referred to above, are subject to the selection of sites by the customers. All sales are subject to certain other conditions including the securing of various approvals, some of which have not yet been complied with. The Company has never had any significant difficulty in complying with such conditions and does not anticipate that it will have any in connection with the sales referred to.

Sales of modules are recognized by the Company for accounting purposes when units are manufactured and assigned to specific contracts. Installation work is recorded on the percentage-of-completion method. The Company's receivables consist primarily of two categories: billed and unbilled. Billed receivables represent amounts which have been invoiced to customers on either contracts in process or completed contracts. Unbilled receivables represent amounts included in sales on contracts in process for which billings will be rendered in the future in accordance with the contracts. See Note 3 of Notes to Consolidated Financial Statements.

Cash Receipts and Working Capital

The following table displays the Company's experience for the fiscal year and nine months ended April 30, 1971 with respect to sales as they are recorded for accounting purposes and cash receipts; and the production of modules in the manufacturing facility as compared with installations at the site for the periods shown. See Note 3 of Notes to Consolidated Financial Statements.

	Sales	Cash Receipts	Modules	
			Manufactured	Installed
Year ended July 31, 1970	\$22,554,000	\$10,774,000	5,184	1,281
Nine months ended April 30, 1971	24,654,000	9,023,000(1)	4,526	1,740
	<u>\$47,208,000</u>	<u>\$19,797,000</u>	<u>9,710(2)</u>	<u>3,021</u>

(1) Of this amount, \$3,000,000 was received from U. S. Shelter Corporation, the Company's wholly-owned unconsolidated subsidiary, in consideration of the assignment to it, without recourse, of a part of the Company's receivables under a contract with a customer. Until collection of this receivable, the Company will pay interest equal to U. S. Shelter Corporation's rate, which was 7% per annum as of April 30, 1971.

(2) Of the uninstalled modules, at April 30, 1971, 2,862 were stored near the Company's plant, 3,759 were located at or near installation sites and 68 were in transit.

(3) A material amount of contract receivables was not collected within one year from the time the sales were recorded.

For the year and nine months ended April 30, 1971 a large part of the Company's sales of dwelling units were pursuant to federally funded turnkey contracts with local housing authorities which provide for payment only after completion of the work and receipt of all approvals necessary for occupancy and do not provide for progress payments. See "Business—Financing." While production of modules and production costs continue throughout the year, the installation of modules is sometimes delayed by zoning and/or engineering requirements, adverse weather conditions or other causes. There has been no seasonal variation in the manufacture of modules but there has been some seasonal variation in the installation of modules and related site work due to weather conditions. As a result of these factors, and also because of the growth in production and sales volume over the period, it is necessary for the Company to improve its working capital position and cash flow.

Accordingly, in recent months the Company has shifted a significant portion of its sales efforts towards customers which can enter into contracts providing for cash progress payments thereby reducing the necessity of the Company carrying the receivables for an extended period of time prior to the receipt of cash. The receipt of progress payments does not change the Company's present method of accounting for revenues. In addition, the Company is attempting to expedite the installation of its modules through the increased use of subcontractors as well as its own installation personnel. In either case, the Company personnel supervise this activity. An increase in the installation rate is an important factor in the completion of contracts and the receipt of cash.

The Company has begun negotiations with certain banks for a one year revolving credit agreement for working capital purposes, in an amount equal to 60% of eligible receivables, the loans not to exceed \$25,000,000 in the aggregate at any one time outstanding. The proposed agreement may provide that borrowings thereunder will be subject to the condition that the Company will reduce the number of uninstalled modules to no more than 3,500 by December 31, 1971 and will have no more than 5,500 uninstalled modules on April 30, 1972 and 3,500 on June 30, 1972. U. S. Shelter Corporation is also negotiating a similar one year revolving credit agreement for the purpose of refunding loans made under the Company's revolving credit agreement and for working capital, in an amount up to 85% of its eligible receivables on a contract by contract basis, the loans not to exceed \$20,000,000 in the aggregate at any one time outstanding or \$30,000,000 if and when the aggregate of uninstalled modules for the Company is reduced to 3,500. The proposed revolving credit agreement of U. S. Shelter Corporation may provide for the assignment, as collateral, of the proceeds due under financed contracts. The proposed terms of the revolving credit agreements are not yet definitive and are subject to change and negotiation of other terms. See "Business—Financing."

Backlog

The Company's backlog consists of a variety of projects, ranging from projects in the early stages of development to projects which have been partially completed, and is represented by contracts, orders, letters of designation or letters of intent. As of April 30, 1971, the Company's backlog was approximately \$179,000,000, which includes a \$100,000,000 order from a nonprofit sponsor. Approximately \$14,000,000 of the backlog will be completed during the year ending July 31, 1971. The \$100,000,000 order is subject to the completion of the plant in Mississippi (see "Business—Property"), and the obtaining of necessary federal funding which cannot now be assured. It is contemplated that this order, which represents approximately 5,000 dwelling units, will be filled over a maximum 7-year period; in all instances, it will be necessary to obtain appropriate sites and various local approvals.

Of the remaining \$79,000,000 of backlog, approximately \$20,000,000 represents work to be completed under contracts in process, and \$59,000,000 is subject to the fulfillment of one or more conditions, such as the commitment of federal funds, the finalization of contracts and the acquisition of appropriate sites. Although the Company believes that these conditions will be satisfied, it can give no assurances in this regard.

*Manufacturing**Assembly-Line Manufacture of Modules*

The townhouse modules are manufactured at the Company's Avon plant on a center assembly-line process. At the first work station the floor assembly is built. At succeeding work stations, wall systems, ceiling systems, roof systems, kitchen assemblies, electrical systems and fixtures, plumbing systems and fixtures, heating systems and fixtures, insulation, doors and trim, ceramic tile, resilient flooring or carpeting and, when ordered, air conditioning systems, stoves and refrigerators are added in sequence. As the modules progress down the assembly-line, constituent parts are cut to size, shaped and assembled on either side and overhead of the assembly-line and are installed in the module. The module is then wrapped in weather-proof plasticized paper for temporary storage or shipment. In a separate facility the Company manufactures components, such as cabinets and stairs, which are installed on the assembly-line.

At the current operating level, the number of modules that can be produced in a day varies from about 30 to 40, depending on the type of modules being produced. The production facility to be constructed in Guliport, Mississippi is intended to have the capacity to complete 100 modules in a day. See "Properties—Mississippi Plant". The Company has been granted a U. S. patent and has foreign applications pending with respect to its assembly-line method of manufacturing modules. It can give no assurance that such foreign applications will be successful.

Use of Conventional Materials

The Company uses conventional building materials. It utilizes gas heat (townhouse) or electric heat (high-rise), double party wall and separate ceiling/floor systems, copper water piping, adhesives, nail and screw fastenings and vinyl interior wall coverings. Many components, such as fixtures, appliances and hardware, are purchased ready for installation from independent suppliers. The Company does not have long term purchase contracts with its suppliers; however it believes its raw materials and components are readily available from alternative sources. According to the desired specifications of a particular customer, various interchangeable materials may be utilized with no adverse effect on production efficiency.

The Company performs quality control inspections throughout the manufacturing process. The Company believes its manufacturing system, which eliminates exposure of the materials to the elements during manufacture, enables it to process and install materials in prime condition and to maintain greater

quality control and uniformity in its housing than exist in the conventional housing industry. The Company warrants the materials and workmanship of its modules and site improvements for one year from the date of purchase by a customer.

Time Factors

Since on-site construction requirements are reduced to a minimum, reliance upon favorable weather and other local conditions is minimized. Accordingly, the Company's modular housing system permits the complete installation of a housing unit, from excavation of the foundation to occupancy, in less time than is required by conventional construction and eliminates to a large extent clean-up after completion of the project. The reduced construction time lessens the amount of interest costs incurred during development and shortens the interval between the commencement of a project and occupancy and the production of income. Where relocation of families is required, as may be the case in low income housing, the relocation period is appreciably shortened. Although the Company has experienced only minor delays in its site work, it can give no assurance that it will not encounter delays in the future.

Transportation of Units

The Company ships modules to sites and staging areas by flatbed trailer and railroad flatcar. It owns 141 trailers and four tractors and leases 50 flatcars. The Company also utilizes independent carriers which furnish additional tractors and drivers. Shipments by truck, because of cost factors, are not generally made beyond a radius of about 400 miles; shipments by rail may be made to destinations 1,500 miles from the plant site. Upon the completion of its new facility to be constructed at Gulfport, Mississippi, which will include an 8,500 foot loading dock, the Company intends to ship modules by barge over inland waterway systems as well as by truck or rail where appropriate.

Codes and Legislation

The Company's products are subject to the requirements of local building codes. In its opinion, the Company has established building specifications which meet the requirements of most of these codes. Prior to the commencement of a project, the specific local code is studied by the Company to insure that its product will comply with it. In this connection, representatives of the New York Board of Fire Underwriters inspect the wiring in the modules on the assembly-line and render their approvals in the factory. The location, site plan and installation of its modular units are also subject to local zoning and other similar ordinances.

Minor delays in the completion of its building projects have been experienced by the Company due to the application of such building codes and ordinances. The Company cannot give any assurance that it will not encounter similar delays in the future.

Several states, including New York, have enacted legislation which affects factory built housing. The Company believes that a primary objective of these statutes is the establishment of state-wide standards which may be adhered to by manufacturers in lieu of compliance with various local building codes. However, the Company cannot predict what effect either existing or pending legislation in this area will have on its products or operations.

A Presidential Executive Order issued on March 29, 1971 established a Construction Industry Stabilization Committee to "assure generally conformance of any increase in any wage or salary [established pursuant to a collective bargaining agreement] in the construction industry" with the provisions of such order. It also established an Interagency Committee on Construction to "develop criteria for the determination of acceptable prices in construction contracts as well as criteria for

acceptable compensation, including bonuses, stock options and the like." The Company is unable to predict the impact, if any, of this Executive Order and its implementation on the Company's operations.

Federal and state regulations limit the dimensions and weight of loads permitted on rail and highways. Such regulations have not had a material adverse effect on the operations of the Company.

Labor Relations

The Company employs about 1,000 people exclusive of site labor, of whom about 365 are executive, administrative or clerical with the balance engaged in production. In September 1968 the production employees were organized in an industrial unit by the United Brotherhood of Carpenters and Joiners of America, the largest of the building trades unions, representing approximately 30% of all building trades union employees. The Company thereafter entered into a collective bargaining agreement, expiring in September 1971, with the local union providing an industrial contract covering all production employees. The Company anticipates that negotiations relating to a new collective bargaining agreement will commence in the near future. While it does not expect any difficulty in negotiating such contract, it can give no assurance in this connection.

In June 1969 the Company entered into an international agreement with the national office of the United Brotherhood of Carpenters and Joiners of America. Under this contract the Union has agreed to furnish competent journeymen on a non-discriminatory basis to install Company modules anywhere within the jurisdiction of the Union. In return, the Company has agreed to recognize the jurisdictional claims of the Union and not to subcontract any work within the Union's jurisdiction which is to be performed at the job site except to a contractor who is a party to an agreement with the Union or who agrees in writing to be bound by the terms of the aforementioned agreement. As a result, the modules are manufactured and dwellings are installed completely by building trades union labor. The Company has had no strikes or interferences with its production or on-site erection of its dwelling units as a result of labor disputes with its employees.

Freedom from work interruptions as a result of labor problems is important to the continued success of the Company's business. The Company believes that the above-mentioned agreements have contributed to its present satisfactory labor relations.

The Company and the Union have agreed to cooperate in a program to provide free training and job opportunities to unemployed unskilled labor and have established an educational program at the Company's Avon plants. The United States Department of Labor and the New York State Department of Labor have awarded the Company manpower grants to assist in the training, in cooperation with the Union, of unemployed unskilled workers in the Rochester area. The Company also offers a continuing education program to all of its employees, with over 90 courses ranging from the skills required on the assembly-line to computer simulation exercises for management.

Financing

The Company believes that its assembly-line produced modular housing is particularly suited to assist in meeting the aims of the federal low rent and moderate income housing programs by permitting the erection of large numbers of approved units in much less time than is possible with conventional construction methods. The Company has directed and intends to direct a significant portion of its sales efforts toward local housing authorities qualified for various forms of financial assistance from HUD and toward private non-profit organizations which sponsor housing for families eligible to receive rental assistance under the National Housing Act. All of the contracts entered into by the Company during the year and nine months ended April 30, 1971 have been fixed price contracts.

Financing Sales to Local Housing Authorities

Townhouses have been sold to ten local housing authorities in New York, Ohio, Pennsylvania, Massachusetts, Maine, and Washington, D. C. A qualified local housing authority, in order to raise funds to pay the Company, borrows funds for a period of 60 days to one year, either in the form of a direct loan from HUD, or more commonly, by issuing tax exempt notes which are sold in the private money market and are secured by the full faith and credit of the United States Government. Thereafter, HUD, as the agent for the local housing authority, sells bonds of the local housing authority to pay off the short term indebtedness of the authority and to provide permanent financing for the project. Local housing authority bonds are normally sold with maturities of up to forty years. The bonds are tax exempt and, like the notes mentioned above, are secured by the full faith and credit of the United States Government.

U. S. Shelter Corporation

During the past fiscal year U. S. Shelter Corporation ("Shelter") was organized as a wholly-owned subsidiary of the Company to provide interim and long-term financing services to purchasers of the Company's modular housing. Under Section 236 of the National Housing Act, the Federal Housing Administration ("FHA") may insure a mortgage, held by a qualified mortgagee, which is equal in principal amount to 100% of the costs of a project incurred by a qualified non-profit mortgagor-sponsor. The FHA has approved Shelter as a qualified mortgagee. Where a Company's customer desires financing to cover the costs of acquiring land, purchasing and installing the modules, and preparing the site, Shelter will agree to supply temporary funds and to provide permanent mortgage financing after it has obtained a commitment from the FHA to insure the permanent mortgage, secured another form of federal assistance, or arranged for permanent financing from private institutional sources. Upon obtaining such a commitment, Shelter will borrow the funds necessary for interim financing from private institutional sources, and lend such funds to the Company's customer. Shelter's borrowings will not be guaranteed by the Company. For its services, Shelter charges a fee which is based on the principal amount of the permanent mortgage. See Note 1 of Notes to Consolidated Financial Statements.

Shelter has been given approval to sell mortgages to, and buy mortgages from, the Federal National Mortgage Association and the Government National Mortgage Association. During the nine months ended April 30, 1971 Shelter's earnings were derived from the accrual of fees aggregating \$300,000, which will not be received until the mortgages close.

Financing Sales to Non-Profit Sponsors

The Company has made sales to, or received orders (subject to federal approval) from, non-profit sponsors in New York, Mississippi, Ohio, Indiana, Massachusetts, West Virginia and Maine. Section 236 of the National Housing Act provides indirect rental assistance to eligible low and moderate income families through periodic interest reduction payments by HUD to the mortgagee in amounts which effectively serve to reduce the mortgagor's obligation to the repayment of principal plus 1% interest. Section 236 housing developments are also eligible for rent supplement payments by HUD to the non-profit sponsor for up to 40% of the dwellings in the development when rents are less than the amounts required to meet debt service and operating expenses.

Legal Proceedings

Homasote Company has alleged that the Company is wrongfully using the word "Homex" in its name on the ground that the use constitutes a violation of the registered trade name "Homex", which Homasote holds on pre-molded wood-fiber strips for use as expansion joint fillers in concrete and masonry construction. The Company has denied the claim and, in August 1969, brought an action

against Homasote in the United States District Court, Western District of New York, for a declaratory judgment that it may continue to use the word "Homex". In the same court, Homasote then brought an action to enjoin the use by the Company of the word "Homex", for an accounting and for unspecified damages. In the opinion of the Company, there are valid defenses to the claims alleged.

The Company is a defendant in an action commenced in the United States District Court, Southern District of New York in March 1971. The plaintiff, a former stockholder of the Company, alleges that he suffered \$1,575,000 in damages by reason of an alleged conspiracy between the Company and a co-defendant broker to force plaintiff to sell 90,000 shares of the Company's Common Stock at a price substantially below its alleged market value. The shares of Common Stock of the Company owned by the plaintiff were not registered under the Securities Act of 1933 and were represented to have been acquired for investment in August 1968. The plaintiff has also asked for treble damages. In the opinion of the Company, it has valid defenses to the claims alleged.

Competition

The Company's principal customers are local housing authorities and non-profit sponsors. The usual practice for a local housing authority is to entertain competing proposals. The major factors which affect a customer's decision include price, design and quality of product, responsibility of the builder and speed with which a project may be completed.

The Company must compete with numerous conventional builders, many of which possess much greater resources than the Company. In addition, conventional methods have a greater acceptance with many developers and housing authorities. The Company believes, however, that its manufactured housing is competitive in price and quality with conventional housing. There are other companies, some of which possess much greater resources than the Company, that have announced their intention to use, and may be using, an assembly-line manufacturing technique similar to that used by the Company, or which are actively engaged in research into such technique.

PROPERTIES

Avon Facilities

The Company's principal office and factory are located on 57 acres of land owned by it in Avon, New York. They consist of a brick and steel office building and an adjoining concrete block factory having an aggregate area of about 140,000 square feet. The original plant was erected in 1967, and a 75,000 square foot addition was completed in early 1971.

In 1969, the Company purchased a one story steel and masonry building containing approximately 48,000 square feet and five acres of land in Avon near its main location. It is used to manufacture components for the housing modules, and contains offices and classrooms used in the Company's education program.

During 1970 the Company constructed a four story prototype modular high-rise building adjacent to its Avon plant and an observation center, containing the electronic controls for the hydraulic jacks, from which the high-rise system may be viewed and studied. See "Business—The High-Rise".

Mississippi Plant

Construction of a manufacturing plant in Gulfport, Mississippi, capable of producing 100 finished modules per day upon completion, is expected to be commenced in September 1971. It is anticipated that the facility will be 350,000 square feet in area and will employ approximately 2,000 persons. Capital expenditures in connection with the plant are expected to be approximately \$4,900,000. In a contract with the Company, Harrison County (where the plant site is located) has agreed to take the steps

necessary to authorize the issuance and sale of tax exempt industrial revenue bonds in an amount up to \$4,900,000, and to use the proceeds to meet the cost of constructing and equipping the plant. If such sale is not consummated, the Company will arrange to finance the cost of the facility itself.

On March 17, 1971, the Company leased 100 acres on which the facility is to be located from Harrison County and its Development Commission under a 30-year lease providing for a rental of \$36,325 per annum, with 60 one-year renewal options at an annual rental of \$25,000. The lease gives the Company an option to purchase the land and the facility at the end of the initial term and each renewal term for \$100. If the bonds are sold, the Company will pay, as additional rent, all amounts necessary to pay principal and interest on the bonds when due.

The Company plans to produce its townhouse, apartment and high-rise modules at Gulfport. This facility will have its own rail spur and loading dock.

MANAGEMENT

The directors and executive officers of the Company are:

<u>Name</u>	<u>Office</u>
David Stirling, Jr.*	Chairman of the Board of Directors and Chief Executive Officer
William G. Stirling*	President and Director
Harold M. Yanowitch*	Executive Vice President, General Counsel and Director
E. A. Bartz	Vice President and Secretary
Frank Csapo	Vice President-Manufacturing
Reuben K. Davis	Vice President and Assistant Secretary
Newman J. Evans	Vice President-Marketing
Gary L. Hammons	Vice President-Real Estate and Installation Division
Herman D. Hillman	Vice President
Victor G. Pappas	Vice President-Personnel
Arthur E. Rosfeld	Vice President-Program Planning
Thomas Santa Lucia	Vice President
Edwin J. Schulz	Vice President and Controller
David Stirling, Sr.	Vice President and Director
Carl L. Wren	Vice President-Market Research
Paul M. Kuveke, Jr.	Treasurer
C. W. Marshall	President, U.S. Shelter Corporation and Director
Theodore W. Kheel	Director
John W. Castellucci	Director

* Member of Executive Committee.

Prior to organizing the Company in July 1968, David Stirling, Jr., William G. Stirling, David Stirling, Sr. and Frank Csapo had been officers of Stirling Bros., Inc., a multi-family housing development and operating company, since its organization in 1962.

Harold M. Yanowitch had been engaged in the practice of law for more than 20 years before joining the Company in 1969. Prior to joining the Company, Mr. Yanowitch was a senior partner in the law firm of Yanowitch, Frank & Garrity.

E. A. Bartz was Controller of Stirling Bros., Inc. from 1966 to August 1968 when he joined the Company as Treasurer. Prior to 1966 Mr. Bartz was Controller of a real estate investment company for twelve years.

Reuben K. Davis joined the Company in 1969. A lawyer, Mr. Davis previously had been a public official in the City of Rochester for more than three years.

Newman J. Evans, for more than three years before joining the Company in 1968, was General Sales Manager for the Iron City/Whitmer Jackson Company, Pittsburgh, Pennsylvania.

Gary L. Hammons joined the Company in 1970. For more than five years prior thereto he was with the Kroger Company as vice president—property.

Prior to joining the Company in 1970, Herman D. Hillman directed the U. S. Department of Housing and Urban Development's programs of the Housing Assistance Administration (low-rent, college and senior citizens) in the New York and New England states. Mr. Hillman, a lawyer, first joined the Legal Staff of the U. S. Housing Authority in 1939.

Victor G. Pappas has been with the Company since 1969. Prior thereto, for more than three years, he was Corporate Director of Personnel for a subsidiary of The Singer Company.

Arthur E. Rosfeld joined the Company in 1969. During the previous year he was employed as Acting Deputy Assistant Secretary for the Housing Assistance Administration of HUD. From May 1967 to September 1969, Mr. Rosfeld also served as the Director of the Operational Services Division of the Regional Housing Administration of HUD and from September 1966 with the Assistant Secretary for Renewal and Housing Assistance. During the two years prior thereto, Mr. Rosfeld worked as a private consultant on urban affairs.

Thomas Santa Lucia engaged in the practice of law in Buffalo, New York for more than three years prior to joining the Company in 1969.

Edwin J. Schulz joined the Company in 1968, after leaving his position as senior systems analyst of Armstrong Cork Co., Inc., a manufacturer of building products where he had been employed since prior to 1964.

Carl L. Wren has directed the Company's market research activities since its inception in July 1968. For more than three years prior thereto, he was with Stirling Bros., Inc.

Paul M. Kuveke, Jr. joined the Company in 1970. From 1967 to 1970 Mr. Kuveke, a certified public accountant, was associated with Irving Trust Company and for the six previous years, he was associated with a firm of certified public accountants.

C. W. Marshall, for more than 20 years prior to joining the Company in 1970, was a senior officer of Central Trust Company, Rochester, New York.

Since 1940, Theodore W. Kheel has been a member of the law firm of Battle, Fowler, Stokes & Kheel and has served as a mediator and arbitrator of labor disputes for approximately 30 years. Mr. Kheel is also a director of Western Union Telegraph Company, Athlone Industries, Inc., Combustion Equipment Associates, Inc. and the Republic National Bank of New York, of which he is also Chairman of the Board of Directors.

Since prior to 1964 John W. Castellucci has been employed by the National Association of Blue Shield Plans, a trade association of medical insurance companies. He has been President since 1967 and served as Executive Vice President prior thereto.

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The following table sets forth the remuneration for the fiscal year ended July 31, 1970 of each director and the three highest paid officers of the Company whose remuneration for the year from the Company and its subsidiaries exceeded \$30,000, and all directors and officers as a group:

<u>Name</u>	<u>Capacity in Which Remuneration was Received</u>	<u>Aggregate Direct Remuneration</u>
David Stirling, Jr.	Chairman of the Board and Chief Executive Officer	\$ 75,557
William G. Stirling	President and Chief Operating Officer	\$ 75,557
Harold M. Yanowitch	Executive Vice President and General Counsel	\$ 70,653
Richard E. Karkow(1)	Executive Vice President and Treasurer	\$ 63,750
David Stirling, Sr.	Vice President	\$ 44,984
All Directors and Officers as a Group (11 Persons)		\$498,310(2)

(1) Mr. Karkow left the employ of the Company in February 1971.

(2) The law firm of which Mr. Kheel is a member received \$50,000 during the year ended July 31, 1970 for services rendered, which amount is not included in the above figure.

Currently, the Company is paying annual salaries of \$125,000 each to David Stirling, Jr. and William G. Stirling and \$100,000 to Harold M. Yanowitch. There are employment agreements terminating in September 1974 with these persons and with David Stirling, Sr., who is receiving an annual salary of \$45,000. Officers and directors as a group will receive aggregate remuneration in the amount of \$814,000 for the year ending July 31, 1971.

ORGANIZATION AND CERTAIN TRANSACTIONS

At the time of the Company's organization Messrs. David Stirling, Jr., William G. Stirling, David Stirling, Sr. and Harper Sibley, Jr. received directly or through corporations which they controlled, an aggregate of 6,400,000 shares of Common Stock of the Company in return for the land, building and manufacturing facilities in Avon, a patent application, processes and know-how relating to the assembly-line manufacture of housing, \$6,000 in cash and the outstanding stock of three corporations in the land and housing development business. The stock of the three corporations and the physical assets acquired had a net aggregate book value of \$111,627 as determined by the accountants for the Company. The land, building and manufacturing facilities had been purchased or constructed by the founders of the Company at a total cost to them of approximately \$400,000, subject to liabilities of approximately \$300,000, and they had paid approximately \$11,000 for the stock of the three corporations.

In June 1969 the Company issued and sold to Harold M. Yanowitch 100,000 shares and to Theodore W. Kheel and designees 200,000 shares of its Common Stock at \$1.00 per share, and on August 11, 1969 issued and sold to Richard E. Karkow, then an officer and director, 100,000 shares at \$1.00 per share. In March 1971, as one of the conditions of the mutual termination of Mr. Karkow's employment agreement with the Company, it repurchased 60,000 of Mr. Karkow's shares for \$180,000.

In 1970 and 1971 the Company advanced \$306,760 for the purchase of building materials for the use of David Stirling, Jr., all of which has been repaid by Mr. Stirling. In 1970 the Company loaned

\$57,500 to Gary L. Hammons, all of which has been repaid. These advances were made without interest. It is the Company's intention not to make loans to its officers or directors in the future unless, in its judgment, such loans would be in the best interest of the Company.

The Company has used the services of Johnston Paviour Sibley, Inc., an insurance broker, in the purchase of its insurance policies and has paid \$205,367 in premiums to such agency since August 1968. Harper Sibley, Jr., a director of the Company until February 1971, and an owner of more than 10% of its outstanding shares of Common Stock, was an officer, director and principal stockholder of such corporation which received commissions on such insurance purchases at the established rates.

In 1969 a subsidiary of the Company sold land to, and developed a modular housing complex in Clay, New York for a limited partnership, of which Messrs. David Stirling, Jr. and William G. Stirling were limited partners, holding in the aggregate one-sixth of the partnership interest. A corporation controlled by Harper Sibley, Jr. made a construction loan of \$2,900,000 in connection with such complex, which loan has been repaid. The project has been completed and a total of approximately \$3,766,000 was paid for the modules and services provided.

In 1969 the Company and a subsidiary completed the final portion of construction work on a modular housing development in Henrietta, New York, known as Fairways, Phase I, for a partnership, of which Messrs. David Stirling, Sr., David Stirling, Jr., William G. Stirling and Harper Sibley, Jr. were partners. Approximately \$919,000 was received for such work.

In 1969 the Company and a subsidiary completed performance of a contract for the sale and erection of modules which had been entered into with a corporation all the stock of which is owned by David Stirling, Jr., William G. Stirling and Harold M. Yanowitch. The work was done at a site in Avon, New York for a price of approximately \$443,000.

Under a contract entered into in 1967 with a corporation, all of the stock of which is held by a corporation which was controlled by Messrs. David Stirling, Sr., David Stirling, Jr., William G. Stirling and Harper Sibley, Jr., a subsidiary of the Company did the on-site construction work at a mobile home park in Clay, New York, owned by such corporation. The subsidiary received approximately \$1,394,000 for such work.

In March 1969 a subsidiary of the Company purchased land from a corporation all the stock of which is owned by David Stirling, Jr., William G. Stirling, David Stirling, Sr. and Harper Sibley, Jr. for \$123,500 and sold it to such corporation in July 1969 for \$128,862 (representing initial costs and improvements).

The Company considers the amounts received by it in the above-described transactions in line with amounts customarily charged for similar products and services.

STOCK OPTION PLAN

The Company has a qualified Stock Option Plan under which, as of May 31, 1971, a total of 888,200 shares of Common Stock were reserved for issuance upon the exercise of options granted or to be granted under the Plan (subject to adjustment for stock splits, stock dividends or any similar change affecting the Common Stock). The options are intended to be "qualified stock options" within the meaning of Section 422 of the Internal Revenue Code. The option price in each instance is 100% of the fair market value of the Common Stock on the date the option is granted, and options expire five years from the date of grant.

In October 1969, Harold M. Yanowitch was granted qualified stock options to purchase 25,000 shares for \$3.00 per share. Since the adoption of the Plan and through May 31, 1971, all directors and officers as a group have been granted options to purchase 195,000 shares at prices ranging from \$3.00 to \$18.00 per share, and in addition, other key employees have been granted options to purchase 335,400 shares at prices ranging from \$3.00 to \$22.00 per share. An officer of the Company has exercised options to purchase 2,000 shares for an aggregate exercise price of \$6,000. The shares had an aggregate market value on the dates of purchase of \$42,775. See Note 10 of Notes to Consolidated Financial Statements.

PRINCIPAL STOCKHOLDERS

Set forth below is certain information as of April 30, 1971, with respect to the beneficial ownership of Common Stock of the Company by each person who owns of record or is known by the Company to own beneficially more than 10% of the outstanding Common Stock of the Company.

<u>Name and Address</u>	<u>Shares of Common Stock Owned</u>	<u>Percent of Outstanding Common Stock</u>
David Stirling, Jr.* 1150 East River Road, Avon, New York	1,909,452	21.6%
William G. Stirling* 1150 East River Road, Avon, New York	1,919,548	21.7
Harper Sibley, Jr.* 200 S.E. First Street Miami, Florida	930,923	10.5
All directors and officers as a group (13 persons)*	4,947,908	55.9

* Includes shares owned beneficially by members of the families of such stockholders.

David Stirling, Jr., William G. Stirling and David Stirling, Sr. may be considered to be "parents" of the Company as that term is defined in the regulations under the Securities Act of 1933.

DESCRIPTION OF CAPITAL STOCK

The following statements are brief outlines of certain provisions of the Company's Restated Certificate of Incorporation (hereinafter called the "Charter"), and the Certificate setting forth the designation and certain of the terms of the Preferred Stock, filed or incorporated by reference as exhibits to the Registration Statement. They do not purport to be complete statements of the provisions referred to, nor do they refer to all provisions of such exhibits, and reference is hereby made to such exhibits for a full statement of all such provisions. No attempt is made to outline or give effect to provisions of statutory or common law.

Under the Charter, the Company is authorized to issue 15,000,000 shares of Common Stock, par value \$.01 per share, and 500,000 shares of Preferred Stock, par value \$1 per share, issuable in one or more series as determined by its Board of Directors which is empowered to fix certain of the terms and provisions of such Preferred Stock. The Board of Directors, acting pursuant to such authority, has assigned the entire 500,000 shares of Preferred Stock to one series, which is the Preferred Stock offered hereby.

The holders of the Preferred Stock are entitled to receive, as and when declared by the Board of Directors out of any funds legally available therefor, cumulative cash dividends at the annual rate shown on the cover page of this Prospectus and no more, payable quarterly on the last day of January, April, July and October before any dividends on the Common Stock shall be paid or declared and set apart for payment. Dividends on the Preferred Stock will be cumulative from the date of issue.

The first dividend on the Preferred Stock offered hereby will be payable on October 31, 1971. Since dividends are cumulative from the date of issue, the amount of this initial dividend will be somewhat less than a full quarterly dividend.

So long as any Preferred Stock remains outstanding, the Company will not make any dividend payment on, or distribution with respect to, or purchase or redeem, the Common Stock unless all past and current dividends on the Preferred Stock have been paid or provided for.

Subject to the foregoing and to the further limitations referred to below, dividends may be paid on the Common Stock as and when declared by the Board of Directors out of any funds legally available therefor.

Liquidation Rights

The holders of the Preferred Stock are entitled to receive, before any distribution or payment may be made to the holders of the Common Stock, (a) in the event of voluntary liquidation, the redemption price applicable at the time in the case of redemption at the option of the Company, and (b) in the event of involuntary liquidation, \$40 per share, together in each case with accrued dividends. Holders of the Common Stock are entitled to receive the remaining assets pro rata to their holdings. Neither a consolidation nor merger of the Company nor the sale of all or substantially all of its assets is deemed to be a liquidation.

Redemption Provisions

The Preferred Stock may be redeemed, as a whole at any time or in part from time to time, at the option of the Company, upon at least thirty days' notice, at a redemption price of \$50 per share if redeemed during the 12 months beginning August 1, 1971 with such redemption price decreasing \$1 per share on August 1 in each year thereafter until August 1, 1981 and thereafter at \$40 per share; together in each case with accrued dividends.

Preferred Stock Conversion Rights

The shares of Preferred Stock are convertible, at the option of the respective holders thereof, into full paid and non-assessable shares of the Company's Common Stock on the basis stated on the cover page of this Prospectus. The conversion price is subject to adjustment in certain events, including the issuance of stock of the Company as a dividend on Common Stock; subdivisions, combinations and reclassifications of the Common Stock; the issuance to all holders of Common Stock of rights or warrants entitling them to subscribe for Common Stock at less than the current market price (as defined); and the distribution to all holders of Common Stock of evidences of indebtedness of the Company or securities or assets (other than dividends or distributions in cash out of earnings). Except as stated in the preceding sentence, the conversion price will not be adjusted for the issuance of Common Stock in exchange for cash, property or services, whether upon the exercise of present or future options or warrants or other-

wise. Upon conversion, no adjustments will be made for dividends, and fractions of shares will not be issued but cash payments will be made in respect of such fractions on the basis of the then market price of the Common Stock. The right to convert any shares called for redemption will terminate at the close of business on the last business day before the date fixed for redemption unless default shall be made in payment of the redemption price.

Under the provisions of the Tax Reform Act of 1969 amending Section 305 of the Internal Revenue Code of 1954, which deals with distribution of stock dividends and stock rights, it is possible that in certain circumstances the operation of the conversion price adjustment provisions applicable to the Preferred Stock could result in taxable income to the holders of the Preferred Stock or to the holders of Common Stock if the effect of the adjustment to such conversion price is to increase the proportionate interest of the holders of the Preferred Stock or the holders of the Common Stock in the profits or assets of the Company. In the opinion of Shea Gould Climenko & Kramer, counsel for the Company, in the absence of Treasury Department regulations clarifying the point, the application of these provisions to Common Stock dividends on the Common Stock, stock splits or combinations should not result in taxable income to either holders of Preferred Stock or Common Stock; but no opinion is expressed as to whether other decreases in the conversion price will or will not be taxable at the time and to the extent of the value of such decreases as a constructive dividend to holders of the Preferred Stock.

Voting Rights and Provisions

The Charter provides, in effect, that the holders of the Common Stock shall have exclusive voting rights for all purposes and that the holders of the Preferred Stock shall have no voting rights except as otherwise may be required by law and except as follows:

(1) If dividends on the Preferred Stock shall be in arrears in an aggregate amount equal to at least four quarterly dividends (whether or not consecutive), the number of directors of the Company shall be increased by two and the holders of the Preferred Stock, voting as a class, shall be entitled to elect two directors. Such right to elect two directors shall continue until all arrearages of dividends on the Preferred Stock shall have been paid and the current dividend thereon shall have been declared and set apart for payment.

(2) The Company shall not, without the vote or written consent of the holders of at least 66⅔% of the Preferred Stock at the time outstanding: (a) authorize or increase the authorized amount of any stock ranking prior to the Preferred Stock, or authorize or increase the authorized amount of any stock or obligations convertible into or evidencing the right to purchase any stock ranking prior to the Preferred Stock; or (b) amend, alter or repeal any of the provisions of the Charter or resolutions of the Board of Directors under their power to fix certain of the terms and provisions of the Preferred Stock, so as adversely to affect the rights, powers or preferences of the Preferred Stock; or (c) merge or consolidate unless the resulting corporation will have no class of stock either authorized or outstanding ranking prior to the Preferred Stock except the same number of shares of stock with the same rights, preferences and powers as the stock of the Company authorized and outstanding immediately preceding such merger or consolidation and unless each holder of Preferred Stock immediately preceding such merger or consolidation shall receive the same number of shares, with the same rights, preferences and powers of the resulting corporation.

(3) The Company shall not, without the vote or written consent of the holders of at least a majority of the Preferred Stock at the time outstanding: (a) increase the authorized amount of

Preferred Stock, or authorize or increase the authorized amount of any stock ranking on a parity with the Preferred Stock, or authorize or increase the authorized amount of any stock or obligations convertible into or evidencing the right to purchase any stock ranking on a parity with the Preferred Stock; or (b) sell, lease or convey all or substantially all of its property or business, or voluntarily liquidate, dissolve or wind up its business, or merge into or consolidate with another corporation.

Each stockholder entitled to vote at any particular time in accordance with the foregoing provisions shall be retired and cancelled and not reissued.

Miscellaneous

Shares of Preferred Stock redeemed at the option of the Company or converted into Common Stock shall be retired and cancelled and not reissued.

Except as hereinabove set forth, no holders of capital stock of any class of the Company are entitled to any pre-emptive, conversion or subscription rights. The outstanding shares of Common Stock are, and the shares of Preferred Stock when issued and sold as set forth herein and the Common Stock issued upon conversion thereof will be, full paid and non-assessable.

The Transfer Agent for the Preferred Stock and the Common Stock is Chemical Bank and the Registrar is Chase Manhattan Bank, N.A.

UNDERWRITING

The Underwriters named below, acting through their Representative, Merrill Lynch, Pierce, Fenner & Smith Incorporated, have severally agreed, subject to the terms and conditions of the Purchase Agreement, to purchase from the Company the number of shares of Preferred Stock set forth opposite their respective names. The Underwriters are committed to purchase all of such shares if any are purchased. Under certain circumstances the commitments of non-defaulting Underwriters may be increased.

<u>Name of Underwriter</u>	<u>Address of Underwriter</u>	<u>Number of Shares to be Purchased</u>
Merrill Lynch, Pierce, Fenner & Smith Incorporated	70 Pine Street New York, N. Y. 10005	150,500
duPont Glore Forgan Incorporated	One Wall Street New York, N. Y. 10005	12,000
Eastman Dillon, Union Securities & Co. Incorporated	One Chase Manhattan Plaza New York, N. Y. 10005	12,000
Goldman, Sachs & Co.	55 Broad Street New York, N. Y. 10004	12,000
Hornblower & Weeks-Hemphill, Noyes	8 Hanover Street New York, N. Y. 10004	12,000
Loeb, Rhoades & Co.	42 Wall Street, New York, N. Y. 10005	12,000
Smith, Barney & Co. Incorporated	1345 Avenue of the Americas New York, N. Y. 10019	12,000
Stone & Webster Securities Corporation	90 Broad Street New York, N. Y. 10004	12,000
Bache & Co. Incorporated	100 Gold Street New York, N. Y. 10038	12,000
Shearson, Hammill & Co. Incorporated	14 Wall Street New York, N. Y. 10005	12,000

<u>Name of Underwriter</u>	<u>Address of Underwriter</u>	<u>Number of Shares to be Purchased</u>
American UBS Corporation	40 Wall Street, 34th Floor New York, N. Y. 10005	7,000
Basle Securities Corporation	120 Broadway New York, N. Y. 10005	7,000
Bear, Stearns & Co.	One Wall Street New York, N. Y. 10005	7,000
Burnham and Company	60 Broad Street New York, N. Y. 10004	7,000
CBWL-Hayden, Stone Inc.	767 Fifth Avenue New York, N. Y. 10022	7,000
Clark, Dodge & Co. Incorporated	140 Broadway New York, N. Y. 10005	7,000
Dominick & Dominick, Incorporated	14 Wall Street New York, N. Y. 10005	7,000
Robert Fleming Incorporated	100 Wall Street New York, N. Y. 10005	7,000
Hallgarten & Co.	44 Wall Street New York, N. Y. 10005	7,000
E. F. Hutton & Company Inc.	One Battery Park Plaza New York, N. Y. 10004	7,000
W. E. Hutton & Co.	14 Wall Street New York, N. Y. 10005	7,000
Ladenburg, Thalmann & Co.	25 Broad Street New York, N. Y. 10004	7,000
Paribas Corporation	40 Wall Street New York, N. Y. 10005	7,000
Reynolds & Co.	120 Broadway New York, N. Y. 10005	7,000
L. F. Rothschild & Co.	99 William Street New York, N. Y. 10038	7,000
Shields & Company Incorporated	44 Wall Street New York, N. Y. 10005	7,000
SoGen International Corporation	595 Madison Avenue New York, N. Y. 10022	7,000
Spencer Trask & Co. Incorporated	60 Broad Street New York, N. Y. 10004	7,000
Tucker, Anthony & R. L. Day	120 Broadway New York, N. Y. 10005	7,000
G. H. Walker & Co. Incorporated	45 Wall Street New York, N. Y. 10005	7,000
Walston & Co., Inc.	77 Water Street New York, N. Y. 10005	7,000
Wood, Struthers & Winthrop Inc.	20 Exchange Place New York, N. Y. 10005	7,000
Estabrook & Co., Inc.	80 Pine Street New York, N. Y. 10005	4,500
Faulkner, Dawkins & Sullivan Securities Inc.	One New York Plaza New York, N. Y. 10004	4,500
Thomson & McKinnon Auchincloss Inc.	2 Broadway New York, N. Y. 10004	4,500
C. E. Unterberg, Towbin Co.	61 Broadway New York, N. Y. 10006	4,500
Bacon, Whipple & Co.	135 South La Salle Street Chicago, Illinois 60603	2,500
Dain, Kalman & Quail, Incorporated	100 Dain Tower Minneapolis, Minnesota 55402	2,500

<u>Name of Underwriter</u>	<u>Address of Underwriter</u>	<u>Number of Shares to be Purchased</u>
Laird Incorporated	140 Broadway New York, N. Y. 10005	2,500
McDonald & Company	2100 Central National Bank Bldg. Cleveland, Ohio 44114	2,500
Michum, Jones & Templeton Incorporated	510 South Spring Street Los Angeles, California 90013	2,500
Putnam, Coffin, Doolittle, Newburger Division of Advest Co.	115 Broadway New York, N. Y. 10006	2,500
Rauscher Pierce Securities Corporation	1200 Mercantile Dallas Bldg. Dallas, Texas 75201	2,500
Suez American Corporation	77 Water Street New York, N. Y. 10005	2,500
Watling, Lerchen & Co.	Ford Bldg. Detroit, Michigan 48226	2,500
George D. B. Bonbright & Co.	1 West Main Street Rochester, N. Y. 14614	1,500
Bosworth, Sullivan & Company, Inc.	660 Seventeenth Street Denver, Colorado 80202	1,500
Common, Dann & Co., Inc.	502 Marine Trust Bldg. Buffalo, N. Y. 14203	1,500
Moore & Schley, Cameron & Co.	Two Broadway New York, N. Y. 10004	1,500
Murch & Co., Inc.	330 Hanna Bldg. Cleveland, Ohio 44115	1,500
Newhard, Cook & Co.	400 Olive Street St. Louis, Missouri 63102	1,500
Underwood, Neuhaus & Co. Incorporated	724 Travis Street Houston, Texas 77002	1,500
Wool, Walker & Co.	63 Wall Street New York, N. Y. 10005	1,500
Banque de Bruxelles S.A.	2 Rue de la Regence Brussels, Belgium	7,000
Banque de Neuflyze, Schlumberger, Mallet	12 Place de la Bourse Paris 2E, France	7,000
Banque Rothschild	21, Rue Laffitte Paris 9, France	7,000
Den Norske Creditbank	21 Kirkegaten Oslo, Norway	7,000
S. G. Warburg & Co. Limited	30 Gresham Street London, EC2P 2EB, England	7,000
Total		<u>500,000</u>

The Representative of the Underwriters has advised the Company that sales of Preferred Stock to certain dealers may be made at a concession of \$1.20 per share and that the Underwriters may allow, and such dealers may reallocate, discounts not in excess of \$.50 per share on sales to certain other dealers.

The officers and directors of the Company owning 1,000 or more shares and a stockholder owning 93,400 shares have agreed that, during the period of 90 days from the date of this Prospectus, they will not, without the consent of the Representative of the Underwriters, directly or indirectly, sell, grant any option for the sale of or otherwise dispose of any Common Stock of the Company owned by such persons.

LEGAL OPINIONS

The legality of the securities offered hereby is being passed upon for the Company by Shea Gould Climenko & Kramer, 330 Madison Avenue, New York, New York 10017, and for the Underwriters by Brown, Wood, Fuller, Caldwell & Ivey, 70 Pine Street, New York, New York 10005. A member of Shea Gould Climenko & Kramer participating in this matter and his family beneficially own an aggregate of 600 shares of Common Stock of the Company.

EXPERTS

The financial statements and schedules included herein and elsewhere in the Registration Statement, so far as they pertain to the two years ended July 31, 1970 and the seven month period ended February 28, 1971, have been included herein and in the Registration Statement in reliance upon the respective reports of Harris, Kerr, Forster & Company and Peat, Marwick, Mitchell & Co., independent certified public accountants, and upon the authority of said firms as experts.

ACCOUNTANTS' REPORT

A 371

THE BOARD OF DIRECTORS
STIRLING HOMEX CORPORATION:

We have examined the consolidated balance sheet of Stirling Homex Corporation and consolidated subsidiaries as of February 28, 1971 and the related statements of income, retained earnings, additional paid-in capital and source and application of funds for the seven months then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the consolidated financial position of Stirling Homex Corporation and consolidated subsidiaries at February 28, 1971, and the results of their operations and source and application of funds for the seven months then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Rochester, New York
March 22, 1971

PEAT, MARWICK, MITCHELL & Co.

ACCOUNTANTS' REPORT

A 372

THE BOARD OF DIRECTORS
STIRLING HOMEX CORPORATION:

We have examined the consolidated statements of income, retained earnings, additional paid-in capital and source and application of funds of Stirling Homex Corporation and consolidated subsidiaries for the two years ended July 31, 1970. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the consolidated results of operations, changes in additional paid-in capital and source and application of funds, of Stirling Homex Corporation and consolidated subsidiaries, for the two years ended July 31, 1970, in conformity with generally accepted accounting principles applied on a consistent basis.

HARRIS, KERR, FORSTER & COMPANY

New York, New York
September 21, 1970

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

	February 28, 1971	April 30, 1971 (Unaudited)
Current assets:		
Cash (Note 11)	\$ 5,059,564	\$ 4,756,747
Receivables (Notes 1 and 3)	26,962,235	30,869,149
Inventories:		
Raw materials, work in process and salable merchandise at lower of cost (first-in, first-out) or replacement market (Note 5)	974,660	2,321,011
Land held for development or sale, at cost (Note 5)	1,856,419	1,867,194
Prepaid expenses and other current assets	439,259	246,669
Prepaid and deferred income taxes (Note 9)	557,561	—
Total current assets	<u>35,849,698</u>	<u>40,060,770</u>
Investment in and advance to unconsolidated subsidiary (Note 1)	222,333	221,516
Long-term receivables (Note 4)	541,124	533,674
Property, plant and equipment at cost, less accumulated depreciation and amortization (February 28, 1971—\$449,950; April 30, 1971— \$543,572) (Notes 6 and 8)	8,779,439	9,090,341
Deferred charges, less accumulated amortization (February 28, 1971— \$367,718; April 30, 1971—\$451,790) (Note 7)	<u>1,978,987</u>	<u>2,553,273</u>
	<u>\$47,371,581</u>	<u>\$52,459,574</u>

See accompanying Notes to Consolidated Financial Statements.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	February 28, 1971	April 30, 1971 (Unaudited)
Current liabilities:		
Current portion of long-term debt (Note 8)	\$ 314,588	\$ 307,458
Notes payable to banks—unsecured (February 28, 1971—6¼ to 7½%; April 30, 1971—5¾ to 6½%) (Note 11)	29,700,000	33,700,000
Accounts payable—trade	2,206,633	2,346,211
Accrued interest	280,929	248,066
Accrued expenses and other liabilities	263,041	282,691
Current and deferred income taxes (Note 9)	—	286,370
Total current liabilities	<u>32,765,191</u>	<u>37,170,796</u>
Long-term debt (Note 8)	352,877	320,569
Deferred income taxes (Note 9)	1,318,531	1,419,564
Option deposit on land contract (Note 5)	210,000	210,000
Stockholders' equity:		
Preferred stock:		
Authorized 500,000 shares—\$1.00 par value; issued—none ...	—	—
Common stock (Note 10):		
Authorized 15,000,000 shares—\$.01 par value; shares issued February 28, 1971—8,907,400; April 30, 1971—8,909,000	89,074	89,090
Additional paid-in capital	8,476,638	8,481,422
Retained earnings	4,159,270	4,948,883
	<u>12,724,982</u>	<u>13,519,395</u>
Less treasury stock at cost (60,000 shares)	—	180,750
Total stockholders' equity	<u>12,724,982</u>	<u>13,338,645</u>
Commitments and contingencies (Note 11)		
	<u>\$47,371,581</u>	<u>\$52,459,574</u>

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENT OF INCOME

	Seven months ended	
	February 28, 1970 (Unaudited) (Note 1)	February 28, 1971
Revenues:		
Sales—trade(A):		
Manufacturing division	\$ 7,786,620	\$12,492,770
Installation division	3,573,569	5,136,788
Sales to affiliates(A) (D):		
Installation division	459,941	—
Equity in undistributed net income of subsidiary (Note 1)	—	104,928
Total revenues	<u>\$11,820,130</u>	<u>\$17,734,486</u>
Cost and Expenses:		
Cost of sales(A):		
Manufacturing division	\$ 4,047,006	\$ 8,471,159
Installation division	3,420,337	4,724,067
Administrative and selling expenses	1,514,029	1,642,063
Interest—long term debt	5,862	18,943
—other	298,078	856,634
Total costs and expenses	<u>9,285,312</u>	<u>15,712,836</u>
Income before Federal and state income taxes	<u>\$ 2,534,818</u>	<u>\$ 2,021,600</u>
Income taxes (Note 9):		
Federal—current	969,000	194,000
—deferred	267,000	671,000
State—current	143,000	26,000
—deferred	34,000	89,000
	<u>\$ 1,413,000</u>	<u>\$ 980,000</u>
Net income	<u>\$ 1,121,818</u>	<u>\$ 1,041,600</u>
Average shares outstanding(C) (Note 13)	<u>8,472,400</u>	<u>8,902,250</u>
Earnings per common share(C) (Note 13)	<u>\$.13</u>	<u>\$.12</u>

Alphabetical references refer to Notes to the Consolidated Statement of Income on page 6 of the Prospectus.
See accompanying Notes to Consolidated Financial Statements.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENT OF ADDITIONAL PAID-IN CAPITAL

	Year Ended		Seven Months Ended	Nine months Ended
	July 31, 1969	July 31, 1970	February 28, 1971	April 30, 1971 (Unaudited)
Balance at beginning of period	\$ —	\$1,949,813	\$8,446,738	\$8,446,738
Excess of proceeds over par value of 400,000 shares of common stock issued in public offering (less net expenses of \$118,285)	—	5,981,715	—	—
Excess of proceeds over par value of shares of common stock issued in private sales (less applicable expenses) (1970—129,000 shares; 1969—1,968,400 shares)	1,910,949	515,210	—	—
Stock issued at par for cash, patents, copyrights and processes (the last three carried at \$1) 1969 — 2,400,000 shares	—	—	—	—
Excess of book value of assets acquired over par value of 4,000,000 shares of common stock issued (Note 1)	101,627	—	—	—
To increase par value of common stock outstanding as a result of four-for-one stock split	(62,763)	—	—	—
Excess of proceeds over par value of common shares issued under stock options (Feb. 28, 1971 — 10,000 shares; April 30, 1971 — 11,600 shares) (Note 10)	—	—	29,900	34,684
Balance at end of period	<u>\$1,949,813</u>	<u>\$8,446,738</u>	<u>\$8,476,638</u>	<u>\$8,481,422</u>

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Balance at beginning of period	\$ —	\$1,082,481	\$3,117,670	\$3,117,670
Net income	1,082,481	2,035,189	1,041,600	1,831,213
Balance at end of period	<u>\$1,082,481</u>	<u>\$3,117,670</u>	<u>\$4,159,270</u>	<u>\$4,948,883</u>

See accompanying Notes to Consolidated Financial Statements.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

	Year Ended		Seven Months Ended	Nine Months Ended
	July 31, 1969	July 31, 1970	February 28, 1971	April 30, 1971 (Unaudited)
Source of funds:				
Net income	\$1,082,481	\$2,035,189	\$ 1,041,600	\$1,831,213
Charges to income not requiring funds:				
Depreciation and amortization ..	70,085	220,227	220,227	314,539
Amortization of deferred charges	34,002	133,288	200,428	284,500
Deferred income taxes	402,489	184,776	731,266	832,299
Undistributed net income of finance subsidiary (Note 1)	—	—	(104,928)	(84,434)
Funds derived from operations	1,589,057	2,573,480	2,088,593	3,178,117
Net proceeds from public offering of common stock	—	5,985,715	—	—
Net proceeds from private sale of common stock	1,921,870	516,500	—	—
Net proceeds from common stock issued under qualified stock option plan ..	—	—	30,000	34,800
Long-term borrowings	2,549,534	124,677	51,286	51,286
Decrease in long-term receivables	—	43,421	—	7,450
Option deposit received on land contract (Note 5)	—	—	210,000	210,000
Repayment of advances to unconsolidated subsidiary	—	—	57,757	75,163
Total source of funds	6,060,461	9,243,793	2,437,636	3,556,816
Application of funds:				
Purchase of treasury stock	—	—	—	180,750
Additions to property, plant and equipment	702,932	4,422,506	3,753,921	4,159,135
Additions to deferred charges	376,306	735,093	1,235,306	1,893,564
Reduction in long-term debt	164,700	3,052,140	194,898	227,206
Increase in noncurrent portion of long-term receivables	584,546	—	—	—
Investment in and advances to unconsolidated subsidiary	—	—	175,162	212,245
Total application of funds ..	1,828,484	8,209,739	5,359,287	6,673,000
Increase (decrease) in working capital ..	\$4,231,977	\$1,034,054	\$(2,921,651)	\$(3,116,184)

(Continued)

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN WORKING CAPITAL (Continued)

	Year Ended		Seven Months Ended	Nine Months Ended
	July 31, 1969	July 31, 1970	Feb. 28, 1971	April 30, 1971
Increase (decrease) in current assets:				
Cash	\$1,418,498	\$ 1,357,917	\$ 2,281,487	\$ 1,978,670*
Receivables	3,177,642	12,286,631	11,476,116	15,383,030*
Inventories	1,301,067	1,236,215	(920,145)	436,981
Prepaid expenses and other current assets	65,616	34,973	314,494	121,904
Prepaid and deferred income taxes	—	—	557,561	—
	<u>\$5,962,823</u>	<u>\$14,915,736</u>	<u>\$13,709,513</u>	<u>\$17,920,585</u>
Increase (decrease) in current liabilities:				
Current portion of long-term debt and notes payable to banks	\$ 857,399	\$10,721,700	\$17,981,552	\$21,974,422
Accounts payable and accrued expenses	490,456	2,155,635	36,950	163,315
Current and deferred income taxes	382,991	1,004,347	(1,387,338)	(1,100,968)
	<u>\$1,730,846</u>	<u>\$13,881,682</u>	<u>\$16,631,164</u>	<u>\$21,036,769</u>
Increase (decrease) in working capital ..	<u>\$4,231,977</u>	<u>\$ 1,034,054</u>	<u>\$(2,921,651)</u>	<u>\$(3,116,184)</u>

* During the nine months ended April 30, 1971, the Company assigned \$3,000,000 of its accounts receivable, without recourse, to an unconsolidated subsidiary for which that subsidiary paid \$3,000,000 to the Company. See Note 1.

See accompanying Notes to Consolidated Financial Statements.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Information relating to the nine months ended April 30, 1971 is unaudited)

1. PRINCIPLES OF CONSOLIDATION

The Company was incorporated on July 22, 1968 and commenced operations on August 1, 1968. In connection with its organization, the Company issued 4,000,000 shares of its common stock for the outstanding stock of certain predecessor companies. This transaction has been treated as a purchase and the results of operations of these companies have been included in the consolidated statement of income from the date of acquisition. The value ascribed to the stock issued was equal to the tangible net assets of these companies.

The consolidated financial statements include the accounts of the Company and its subsidiaries except for U.S. Shelter Corporation, its financing subsidiary (all of which are wholly-owned). The Company carries its investment in all subsidiaries at equity in the underlying net assets. On consolidation, all significant accounts and transactions with consolidated subsidiaries have been eliminated.

With respect to the figure for the seven months ended February 28, 1970 which are unaudited, the management of the Company believes that all adjustments (none of which were other than normal recurring accruals) necessary to a fair statement of the results for such interim period have been included.

The following are condensed financial statements of the unconsolidated financing subsidiary:

BALANCE SHEET

ASSETS		
	Feb. 28, 1971	Apr. 30, 1971
Cash	\$ 27,893	\$ 3,690
Accounts receivable (Notes a and b)	300,000	3,300,019
Other assets	11,167	10,760
	<u>\$339,065</u>	<u>\$3,314,469</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
Note payable—bank (7%) (Note a)	—	\$3,000,000
Payables and accrued expenses (primarily income taxes payable)	\$116,732	92,953
Due to parent company	17,405	37,082
Stockholder's equity	204,928	184,434
	<u>\$339,065</u>	<u>\$3,314,469</u>

STATEMENT OF INCOME

	From Date of Incorporation (September 25, 1970) to	
	Feb. 28, 1971	Apr. 30, 1971
Finance income (Note c)	\$300,000	\$ 300,000
General and administrative expenses	83,072	125,788
	216,928	174,212
Income taxes	112,000	89,778
NET INCOME	<u>\$104,928</u>	<u>\$ 84,434</u>

NOTES:

(a) The subsidiary has obtained an unsecured \$15,000,000 line of credit from a bank. These funds are being used in financing transactions involving customers of the Company. The Company has not guaranteed this line of credit.

(b) At April 30, 1971, accounts receivable of U.S. Shelter include \$3,000,000 which relates to accounts assigned to U.S. Shelter without recourse by the Company for which U.S. Shelter remitted cash in that amount to the Company. Interest equal to the rate charged on U.S. Shelter's line of credit will be charged to the Company.

(c) Finance income represents a fee earned under an agreement with a non-affiliated customer. The services rendered by U. S. Shelter included obtaining a commitment from a Federal agency for permanent financing of the sponsor's projects. The fee will be substantially collected within one year.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
 (Information relating to the nine months ended April 30, 1971 is unaudited)

2. CHANGES IN ACCOUNTING PRINCIPLES

During the year ended July 31, 1970, the Company changed its method of recording the installation portion of sales contracts from the completed contract method to the percentage-of-completion method. Although this change had no significant effect on results of operations for fiscal years 1969 and 1970, such results have been retroactively restated to provide consistent application of this change.

3. RECEIVABLES

The Company enters into various modular housing sale contracts which contain an allocation of the sales price between modules (based upon published price lists) and installation work. The contracts generally provide for payment upon completion and receipt of all approvals necessary for occupancy or for payment upon completion of each respective phase. "Unbilled" receivables represent amounts included in sales on contracts in process for which billings will be rendered in the future in accordance with the contracts.

Receivables consist of:

	<u>Feb. 28, 1971</u>	<u>Apr. 30, 1971</u>
Contract receivables:		
Billed	\$ 7,801,602	\$10,050,112
Unbilled	18,888,192	20,572,492
Total	26,689,794	30,622,604
Current portion of long-term receivables (Note 4)	10,000	10,000
Other receivables	262,441	236,545
Total receivables	<u>\$26,962,235</u>	<u>\$30,869,149</u>

Substantially all sales are to local housing authorities and sponsors who qualify for financial assistance from Federal agencies of the U. S. Government. In light of this, no provision for doubtful accounts is considered necessary.

See the condensed financial statements of U. S. Shelter Corporation in note 1 for information with respect to receivables assigned by the Company to U. S. Shelter Corporation.

4. LONG-TERM RECEIVABLES

Long-term receivables consist of:

Mortgages receivable:

	<u>Feb. 28, 1971</u>	<u>Apr. 30, 1971</u>
Mortgage due June 1, 1974—payments of \$2,500 due quarterly with interest at the prime commercial rate in effect on the interest payment date	\$249,124	\$241,674
Mortgage due June 30, 1975—payments of \$25,000 due June 30, 1973 and June 30, 1974 and the balance due June 30, 1975. Interest payable annually at the prime commercial rate in effect on the interest payment date	302,000	302,000
	551,124	543,674
Less installments due within one year	10,000	10,000
	<u>\$541,124</u>	<u>\$533,674</u>

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Information relating to the nine months ended April 30, 1971 is unaudited)

During the year ended July 31, 1969, a subsidiary of the Company sold two parcels of land for a profit before income taxes of \$425,956. The sales accounted for approximately 18% of the Company's net income for the year. Payment of the purchase price is secured by the mortgages enumerated in the table above.

5. INVENTORIES

(a) Inventories of the Company consisted of the following:

	Total	Salable Merchandise	Work in Process	Raw Materials
July 31, 1969	\$1,137,299	\$ 653,872	\$ 12,000	\$ 471,427
July 31, 1970	2,167,603	1,064,408	139,531	963,664
Feb. 28, 1971	974,660	—	241,417	733,243
April 30, 1970	2,982,752	1,910,995	45,000	1,026,757
April 30, 1971	<u>\$2,321,011</u>	<u>\$ 852,949</u>	<u>\$ 321,398</u>	<u>\$1,146,664</u>

(b) Land held for development or sale is recorded at cost plus real estate taxes, mortgage interest and other related carrying costs. The land was acquired by the Company as a part of the transaction described in paragraph one of Note 1.

The Company has entered into a contract to sell a parcel of the land with costs of \$673,017 for a sale price of \$2,100,000. The Company has received a down payment of \$210,000 which has been accounted for as an option deposit.

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following:

	Feb. 28, 1971	April 30, 1971
Land and land improvements	\$1,066,654	\$1,123,681
Buildings	4,433,229	4,813,487
Machinery and equipment	1,370,419	1,517,063
Furniture, fixtures and office equipment	685,223	905,031
Other	92,171	108,754
Construction in progress	1,581,693	1,165,897
	<u>9,229,389</u>	<u>9,633,913</u>
Less accumulated depreciation and amortization ..	449,950	543,572
	<u>\$8,779,439</u>	<u>\$9,090,341</u>

Buildings are depreciated on the straight-line method over an estimated useful life of forty-five years. All other items are depreciated on the straight-line method over estimated useful lives ranging from one to twenty years. Maintenance and repairs are charged to expense as incurred. Renewals and betterments are capitalized. When properties are retired, sold or otherwise disposed of, the cost and the

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Information relating to the nine months ended April 30, 1971 is unaudited)

related accumulated depreciation and amortization is removed from the accounts, and gains and losses resulting from such transactions are reflected in income.

7. DEFERRED CHARGES

The unamortized balances of deferred charges consist of:

	Amortization Period	Unamortized Balance (b)		Net Increase from Aug. 1, 1970 to Apr. 30, 1971
		Feb. 28, 1971	Apr. 30, 1971	
Patents pending and trademarks	Legal Life	\$ 123,508	\$ 140,567	\$ 51,967
Training and professional development	3 years	314,356	406,814	258,178
Research and development	5 years	381,880	490,099	405,603
Project and production start-up costs	2 to 5 years	880,091	930,039	427,517
Property acquisition costs	(a)	221,057	425,227	306,449
Miscellaneous	1 to 5 years	58,095	160,527	159,450
		<u>\$1,978,987</u>	<u>\$2,553,273</u>	<u>\$1,609,164</u>

(a) Expenditures in connection with property acquisition will be added to the cost of property subsequently acquired.

(b) See Note 12.

In the event of project abandonment or other circumstances causing a loss of value to deferred items, the related unamortized costs are charged to current operations.

The increase in deferred charges is principally attributable to continuing development of the Company's high-rise apartment system, low-rise townhouses and apartment/hotel units, installation and start-up of computer systems, plant start-up costs for the Company's new manufacturing facility in Avon, applications for U. S. and foreign patents and trademarks, and costs attributable to the issuance of the Preferred Stock offered hereby. These additions to deferred charges other than costs attributable to the issuance of the Preferred Stock, represent approximately 39% of income before Federal and state income taxes for the nine months ended April 30, 1971.

8. LONG-TERM DEBT

Long-term debt consists of the following:

	Feb. 28, 1971	Apr. 30, 1971
Mortgages maturing at various dates through December 31, 1976 and bearing interest at rates ranging from 4¾% to 6%	\$541,594	\$516,185
Installment contracts and lease purchase agreements maturing at various dates through August, 1974	125,871	111,842
	<u>667,465</u>	<u>628,027</u>
Less payments due within one year	314,588	307,458
	<u>\$352,877</u>	<u>\$320,569</u>

Land, buildings and equipment with a net book value of \$1,684,000 and \$1,682,000 as of February 28, 1971 and April 30, 1971, respectively, were encumbered under the above agreements.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Information relating to the nine months ended April 30, 1971 is unaudited)

The required principal payments on long-term debt for the next five years are as follows:

	Feb. 28, 1971	Apr. 30, 1971
1973	\$212,936	\$208,752
1974	95,845	70,950
1975	23,278	21,862
1976	17,330	15,611
1977	3,488	3,394

9. INCOME TAXES

Deferred taxes relate principally to depreciation, deferred and capitalized costs, installation contracts and installment sales. None of the Company's tax returns have been examined by the Internal Revenue Service.

10. STOCK OPTIONS

The Company has a qualified stock option plan in effect whereby options to purchase shares of common stock may be granted to officers and key employees at not less than the fair market value on the date of grant. During February, 1971, authorized shares under the plan were increased from 400,000 to 900,000 shares. Options expire five years after the date of grant and are exercisable in cumulative installments of 20% after one year. A summary of activity follows:

(1) Options outstanding at April 30, 1971:

Period granted	Shares (net of cancellations)	Option and market price at grant per share		Total
		From	To	
Year ended July 31, 1970	333,800	\$ 3.00	\$16.50	\$2,973,100
Seven months ended Feb. 28, 1971	172,000	15.50	19.75	2,996,750
Two months ended April 30, 1971	29,000	22.00	25.75	664,250
	<u>534,800</u>			<u>\$6,634,100</u>

(2) Shares for which options first became exercisable:

	Shares	Option value	Market value	Option price	Market price
Seven months ended Feb. 28, 1971	53,760	\$396,720	\$1,165,807	\$ 3.00 to \$16.50	\$18.75 to \$23.75
Two months ended April 30, 1971	—	—	—	—	—
	<u>53,760</u>	<u>\$396,720</u>	<u>\$1,165,807</u>		

(3) Shares for which options were exercised:

	Shares	Option value	Market value	Option price	Market price
Seven months ended Feb. 28, 1971	10,000	\$ 30,000	\$ 198,692	\$ 3.00	\$18.00 to \$21.50
Two months ended April 30, 1971	1,600	4,800	35,400	\$ 3.00	\$22.13
	<u>11,600</u>	<u>\$ 34,800</u>	<u>\$ 234,092</u>		

No entries are recorded with respect to options until exercised at which time the excess of the option price over the par value of common stock issued is credited to paid-in surplus.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Information relating to the nine months ended April 30, 1971 is unaudited)

11. COMMITMENTS AND CONTINGENCIES

An action has been brought to enjoin the use of the word "Homex" by the Company. In the opinion of legal counsel for the Company, the plaintiff will be unsuccessful in obtaining the relief which it seeks.

On January 21, 1970, the State of New York asserted a proposed deficiency in sales and use taxes against the Company in the aggregate net amount of \$147,233, excluding penalties and interest. A protest to this proposed deficiency was filed on May 21, 1970, and in the opinion of legal counsel there appears to be a valid defense against the claim.

A complaint was served on March 2, 1971, in an action against the Company and another party, a broker, to recover damages allegedly suffered by a former shareholder of restricted shares of Company common stock. It is claimed that the Company refused, in concert with the other party, to permit the transfer of plaintiff's stock except at a price substantially below market. Compensatory damages in the amount of \$1,575,000 and treble damages are alleged. In the opinion of management, the suit can be successfully defended. In the opinion of counsel, the claim for treble damages is without merit.

The Company is committed to construct a new manufacturing facility. See "Properties—Mississippi Plant".

At February 28, 1971, and April 30, 1971, the Company had leases on various equipment and office facilities with terms ranging from two to six years. Minimum annual rentals under such leases amount to approximately \$390,000.

Notes payable consist of 90 day unsecured notes to eleven banks bearing interest at a rate $\frac{1}{2}\%$ above the respective bank's best rate on the date of issue. The Company is required to maintain average annual compensating balances at each of these banks equal to approximately 15% to 20% of the outstanding indebtedness to such bank.

STIRLING HOMEX CORPORATION AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Information relating to the nine months ended April 30, 1971 is unaudited)

12. SUPPLEMENTARY PROFIT AND LOSS INFORMATION

	Year ended July 31, 1969	Year ended July 31, 1970	Seven months ended February 28, 1971	Nine months ended April 30, 1971
Maintenance and Repairs:				
Cost of sales	\$ 22,221	\$ 84,386	\$122,826	\$165,748
Other	257	8,479	21,007	51,383
	<u>22,478</u>	<u>92,865</u>	<u>143,833</u>	<u>217,131</u>
Depreciation and Amortization:				
Cost of sales	67,985	193,804	145,936	191,175
Other	2,100	26,423	74,291	123,364
	<u>70,085</u>	<u>220,227</u>	<u>220,227</u>	<u>314,539</u>
Amortization of Deferred Charges:				
Cost of sales	—	—	—	—
Other	34,002	133,288	200,428	284,500
	<u>34,002</u>	<u>133,288</u>	<u>200,428</u>	<u>284,500</u>
Taxes Other than Taxes on Income:				
Payroll taxes:				
Cost of sales	89,846	187,190	181,765	259,975
Other	7,540	26,757	78,448	109,106
Land cost	476	—	—	—
	<u>97,862</u>	<u>213,947</u>	<u>260,213</u>	<u>369,081</u>
Property Taxes:				
Cost of sales	6,347	18,594	7,502	11,724
Other	—	7,781	16,952	22,300
Land cost	18,452	23,762	43,648	43,648
	<u>24,799</u>	<u>50,137</u>	<u>68,102</u>	<u>77,672</u>
Rents:				
Cost of sales	3,386	76,528	120,253	200,871
Other	11,445	112,889	323,974	445,656
	<u>14,831</u>	<u>189,417</u>	<u>444,227</u>	<u>646,527</u>

There were no management fees, service fees or royalties paid during the above periods.

13. EARNINGS PER SHARE

Earnings per common share are based upon the weighted average number of shares outstanding during the periods presented after giving retroactive effect to the four-for-one stock split effected in February 1970. Stock options outstanding during these periods have not been included in this computation since the effect of their inclusion would be insignificant.

A 387

500,000 Shares

Stirling Homex Corporation

**\$2.40 Cumulative Convertible
Preferred Stock
(Par Value \$1 Per Share)**

PROSPECTUS

**Merrill Lynch, Pierce, Fenner & Smith
Incorporated**

July 29, 1971

A 388

EXHIBIT 7

**¶¶17, 18 Extracted from Affidavit of Richard S.
Simmons Sworn to March 29, 1976**

(Reproduced herein as pages A389 to A390)

17. On Friday, July 2, 1971, I went to Chemical and prior to the luncheon met briefly with W. Richard Hazen, the Chemical officer in charge of this matter. I do not recall whether I saw the draft prospectus before arriving at Chemical or whether I first saw it at Mr. Hazen's office. In any event, Mr. Hazen stated that Chemical was very interested in ascertaining the difficulty Homex would have in complying with an SEC deficiency letter and desired my judgment as to whether there would be such difficulty in complying with the SEC deficiency letter that Chemical should give consideration to other courses of action with regard to its loans to Homex.

At that meeting with Mr. Hazen, I went through the draft prospectus, and looked at the footnotes with regard to an extension of credit to Shelter. As I recall, there were only two footnotes in that draft, one relating to the \$15,000,000 line and the loan made thereunder, the other relating to receivables assigned from Homex to Shelter. A third note, dealing with Shelter's \$300,000 finance income (also the subject of plaintiffs' claim against Chemical), was not in the draft I examined, although it appears in the final version of the prospectus. I asked whether the \$3,000,000 loan referred to was not the same transaction that my associate had been working on. Mr. Hazen confirmed it was. I stated that I did not think the footnote was accurate, since it was my recollection that the RIT loan was being extended on a secured basis.

I asked about the \$15,000,000 line of credit referred to in the draft prospectus and Mr. Hazen showed me the letter which Chemical had written with respect thereto. There was no suggestion by Mr. Hazen that the

letter did not reflect the position of Chemical, or that a line of credit had not been established. I also did not think that the footnote was accurate in that I read the letter as providing for a maximum credit at any one time outstanding of \$3,000,000.

18. Following our discussion, Mr. Hazen and I went upstairs to the luncheon, at which representatives of Merrill Lynch, and Brown, Wood, Fuller, Caldwell and Ivey, the law firm representing Merrill Lynch, were present.

The representative of Merrill Lynch reviewed a fairly lengthy deficiency letter from the SEC. He also stated that it was essential in order to enable Merrill Lynch to go forward with the undertaking that it be assured that Chemical would continue to support Stirling Homex through extensions of credit.

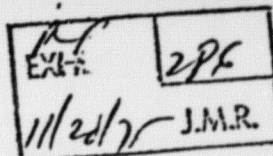
Mr. Hazen responded that Chemical had every intention of continuing to extend credit to Homex but that Chemical wanted such extensions of credit to be made pursuant to a formalized revolving credit agreement with adequate controls, particularly to curtail the speculative building of modules. He stated that Chemical had been concerned about Homex's cash flow problems caused by the time lag between the production of modules and the on-site installation and payment therefor. I also believe that Richard LeBlond, an Executive Vice President of Chemical, made a general statement about the fact that Chemical viewed Homex as making a very substantial contribution in the public housing field and was confident as to its future.

A 391

EXHIBIT 8

**Memorandum Dated May 21, 1971 of P. Prima of
Chemical Bank Addressed to M. Ivanetic and
Others of Chemical Bank**

(Reproduced herein as pages A392 to A395)



YJ

A 392

REPORT OF
INTERVIEW

FOR THE CREDIT FOLDER

NAME STIRLING HOMEX CORPORATION

CITY AVON, NEW YORK

DATE - May 21, 1971

Mivanetic and the writer met with Messrs. Stirling, Yanowitch, Kaveke, Schulz and C. W. Marshall at the Company's Avon Plant. (Please refer also to a w.s. dated 5/21/71 by Mivanetic).

We were given a monthly cash flow projection for the current quarter ending 7/31/71 and a quarterly projection through the next fiscal year, which is attached.

The Company plans to handle three different kinds of deals: turnkey, interim and conventional construction type financing through U.S. Shelter Corporation, its wholly-owned financing subsidiary.

Turnkey

1. Stirling submits proposal (site plans, etc.) to Local Housing Authority (LHA) along with competitors.
2. LHA selects proposal they want (Stirling's) and forwards this to HUD with copy to Stirling.
3. HUD approves and states this in writing to LHA.
4. LHA issues Designation Letter to Stirling which is usually contingent upon the following:
 - a. site acquisition
 - b. approval of site plans and all other plans and specifications of appropriate city agencies
 - c. The submission of a Development Program by the LHA to HUD and the securing of the Annual Contributions Contract
 - d. Issuance of unconditional certificate of occupancy
 - e. One year's guarantee of materials
 - f. Cost must be based on market value appraisal

REPORT OF
INTERVIEW

A 393

FOR THE CREDIT FOLDER

NAME STIRLING HOMEX CORPORATION

CITY AVON, NEW YORK

-2-

DATE - May 21, 1971

Continued.....

5. Contract is executed between Stirling and LHA.
6. Contract of Sale and other documents required under the program are sent to HUD who reviews and sends check to LHA.
7. LHA pays Stirling (By this time 10-12 months may have passed).

Interim

In various forms usually within 120 days after completion of Modules or after local authority has given its approval re zoning, building codes, sites, etc.

Conventional

1. Contract signed with sponsor.
2. Site plans done and have FHA approval.
3. Obtain FNMA/GNMA approval re permanent financing.
4. Shelter arranges construction financing.
5. Shelter borrows cash on strength of 2 and 3.
6. Shelter pays Homex.
7. Shelter is paid by permanent mortgage lenders (Shelter gets fee for arranging the financing and the spread between the interest it borrows at and what it charges customers).

REPORT OF
INTERVIEW

A 394

FOR THE CREDIT FOLDER

NAME STIRLING HOMEX CORPORATION

CITY AVON, NEW YORK

-3-

DATE - May 21, 1971

Continued.....

The Company is very much aware that more interim/conventional financing must be obtained to provide for timely cash flows. As such, it is actively fostering the development of U.S. Shelter Corporation.

Please refer also to the sample contracts I have included in this package.


PPrima/cac

CC: Mivanetic
WRHazen
JRSpringer

PROJECTED CASH FLOW

STIRLING HOMEX

(Million \$'s)

before 6/11/71
A 395

STATUS

		70-71 4th Qter.			71-72 Quarters				Type Contr.
		May	June	July	1	2	3	4	
L	Rochester, RIT				(4.8)				Turnk
Complete*	Worcester, Providence & North	(0.9)			0.6				"
L	" Bridgeport								"
Complete**	Eric, Bird St	(1.3)							"
L	" Grandview					1.9			"
L	" Pittsburg					0.6			"
C 1/28/71	Portland				1.3				"
L	Rochester (4 sites)						2.3		"
L	Washington D.C.					1.2			"
C	Virgin Isles				2.7	0.5			Interi
3/3/71	Ithaca					1.2			"
3/18/70	Akron, Hillwood		1.0	1.0	1.0	2.0	1.9		"
C 11/28/69	Mildred		0.6	0.5					"
C 5/18/70	Wilbeth & Arlington		0.3						"
C 10/9/69	Milton		0.5	1.0	0.4				"
***	Highland				0.5	2.5	2.4		"
***	Miss., GGC			1.5	1.5	3.9	4.5	3.6	"
C	Misc.			0.1	0.2	0.2			"
Total		\$2.2	2.4	4.1	13.0	14.0	11.1	3.6	

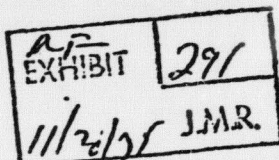
- L - Letter of Designation
 C - Contract and date signed if known
 * - Final approval of work done and costs being reviewed by HUD.
 ** - Final approval held up due to plumber's strike.
 *** - Did not see files, but was informed that there is a firm contract and a funding commitment for the Mississippi project, but specific site plans are yet to be approved.

A 396

EXHIBIT 9

**Memorandum Dated October 13, 1971 from P. Prima of
Chemical Bank to M. Ivanetic and W.R. Hazen
of Chemical Bank**

(Reproduced herein as pages A397 to A398)



(44)
A 397-8

STIRLING WYTEX CORPORATION

AVON, NEW YORK

October 13, 1971

WRH and PPrima visited with David Stirling, Jr., Edwin J. Schulz and Paul M. Kuveke, Jr., to discuss the proposed 1-year \$45,000,000 loan package or \$55,000,000, if and when the uninstalled module level is down to 5000.

The Company gave us a best efforts schedule which shows that the uninstalled module level (those not affixed to a foundation) would peak at about 8600 during October, 1971, and that this level would be below 5000 by April, 1972. The improvement is to result from a greatly accelerated installation rate. We accepted this and agreed to build the numbers into our loan agreement with enough flexibility to compensate for normal installation slippages. Too, we stipulated that the Company would not manufacture more than 500 modules during the "following month" if the agreed upon "previous month's" reduced level was not attained.

These terms will be built into the agreement in such a fashion that the banks would not be obligated to make further advances, if the reduced levels are not attained. Further, the Company will be in default if it didn't meet its best efforts promise and/or if its uninstalled module level at any time exceeded 9000 and if this level was not down to 5500 by April, 1972. In this regard, David Stirling agreed to face the banks to confirm the Company's intentions as indicated above.

It appears that we will try to have a bank meeting in Rochester during the latter part of October. Meanwhile, Paul Kuveke will be preparing the necessary exhibits as of 9/30/71 and agreed to package all the deals that will go into U.S. Shelter (for our prior approval), so that we could effect a smooth closing.

We noted (and the Company acknowledged) that for all practical purposes, the Company should now be abiding by the terms agreed upon.

Unresolved issue - Mississippi project.

PPrima/kc

cc: MIVanetic
WRHazen

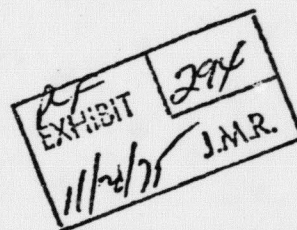
A 399

EXHIBIT 10

**Letter Dated April 3, 1972 from
Chemical Bank to Paul Kuveke**

(Reproduced herein as page A400)

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A 400



Mr. Paul Kuveke
Vice President & Treasurer
Stirling Homex Corporation
1150 East River Road
Avon, New York 14414

April 3, 1972

Re: Consent to April Preferred Dividend Payment
(Reference Loan Agreements dated January 24, 1972)

Dear Paul:

Chemical Bank, as Agent, under the subject Loan Agreement has received verbal notice from all participating Banks that although defaults now exist under the Agreement, the Banks consent to Stirling Homex's payment of the April, 1972 preferred dividend.

Consent is given in this specific instance only without prejudicing or waiving any other rights which the Banks may have under the Loan Agreements.

CHEMICAL BANK
as Agent for the Banks

Vice President

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

A 401

In the Matter of
STIRLING HOMEX CORPORATION,

Consolidated Debtor.

In Proceedings for
Reorganization Under
Chapter X of the
Bankruptcy Act

BK 72-1399

AFFIDAVIT

STATE OF NEW YORK)
 : SS.:
COUNTY OF NEW YORK)

HENRY LEWIS GOODMAN, being duly sworn, deposes and says:

1. I am a member of the firm of Zalkin, Rodin & Goodman, counsel for Chemical Bank, a general unsecured creditor of the Consolidated Debtor in the amount of \$19,991,864.73. The aforementioned claim of Chemical Bank is the aggregate sum of two claims, both of which were allowed by an order of United States District Judge Harold P. Burke dated June 29, 1976.

2. I make this affidavit for the purpose of adducing certain relevant facts and documentary material in support of Chemical Bank's opposition to (i) permitting any prior or present preferred or common shareholders of Stirling Homex Corporation ("Homex") who have not filed claims as "creditors" on or prior to February 19, 1973, to do so at this time, or (ii) including any such "creditor" claims by preferred or common shareholders of Homex, as general unsecured claims, on a parity with other general unsecured creditors of Homex, in any plan of reorganization in the nature of a liquidation to be proposed and filed herein.

3. On July 12, 1972, Homex, the parent company of the Consolidated Debtor, filed a petition under Chapter X of the Bankruptcy Act. On July 13, 1972, an order was made by United

States District Judge Harold P. Burke approving of the filing of the petition and appointing Frank G. Raichle as Reorganization Trustee. Thereafter, Mr. Raichle duly qualified as such Reorganization Trustee and has acted continuously as such to the present time. Following Homex's filing of its Chapter X petition, five subsidiary corporations of Homex filed Chapter X petitions in this Court. In each subsidiary proceeding, the petition was approved as having been filed in good faith, Mr. Raichle was appointed as Reorganization Trustee, qualified as such and has acted as such Reorganization Trustee of each subsidiary until June 29, 1976, when this Court made an order directing the five subsidiaries to be substantively consolidated with Homex. From and after June 29, 1976, Mr. Raichle has been acting as Reorganization Trustee of the Consolidated Debtor.

4. On December 11, 1972, Judge Burke made and entered an order fixing the time and manner of filing and allowing proofs of claim and of stock interests (hereafter the "Bar Order"). A copy of the Bar Order is attached hereto, marked Exhibit "1" and made a part hereof. Paragraph 10 of the Bar Order required the Trustee to mail a copy thereof to all creditors and stockholders of each of the Debtors at the addresses shown on the Debtors' records or as otherwise known to the Trustee and to the Securities and Exchange Commission. In addition, paragraph 10 required the Trustee to publish a copy of the Bar Order once during the month of January in The Wall Street Journal and in the Rochester Democrat and Chronicle, which was done.

5. Paragraph 1 of the Bar Order required all proofs of claim of creditors against the Debtors or their property, of

whatever character, either in tort or in contract, fixed or contingent, liquidated or unliquidated, other than those founded on shares of stock, to be filed with the Trustee on or before February 19, 1973.

6. Pursuant to the Bar Order, eight banks led by Chemical Bank filed secured claims against Homex and one or more of its subsidiaries in the aggregate amount of \$38,000,000. The collateral principally consisted of security interests in the inventory and receivables of Homex and a pledge of all of the stock of Kabeth Properties, Inc., a debtor subsidiary for which Mr. Raichle acted as Chapter X Trustee.

7. Mr. Raichle filed objections to the allowance of the claims of the banks and after a considerable amount of pre-trial discovery, a settlement agreement made as of March 31, 1976 was executed between and among Mr. Raichle, as Reorganization Trustee of Homex and each of its subsidiary debtor corporations, and the banks (the "Settlement Agreement"). The Settlement Agreement was to become effective upon the entry of an order of the Reorganization Court having jurisdiction over the Debtor and each of its subsidiaries, upon notice in accordance with Rule 10-209 of the Chapter X Rules. The objections filed by Mr. Raichle to the secured claims of the banks had been referred by the Reorganization Court to Bankruptcy Judge Edward D. Hayes by orders dated May 15 and May 20, 1975, to "hear and report." On April 5, 1976, Bankruptcy Judge Hayes entered an order fixing a hearing and directing service of a petition of Mr. Raichle dated that same day, for an order approving of the settlement agreement between himself, as Trustee, and the banks. Copies of Bankruptcy Judge Hayes' order and the petition of Mr. Raichle are attached hereto,

marked collectively as Exhibit "2" and made a part hereof. A copy of the Settlement Agreement between Mr. Raichle, as Trustee, and the banks is attached as an exhibit to the petition. The April 5, 1976 order of Bankruptcy Judge Hayes fixed May 10, 1976 as the date of hearing of the Trustee's petition for leave to compromise his objections to the claims against the banks and directed that notice of the hearing be served by mail upon all shareholders of Homex of record as of December 31, 1973, and a subsidiary debtor corporation against which one of the claims was asserted, U. S. Shelter Corporation.

8. At the hearing on May 10, 1976, no objection was filed or noted by anyone to the Settlement Agreement, and on May 14, 1976, Bankruptcy Judge Hayes filed his Findings of Fact and Recommendation, which recommended approval of the Settlement Agreement. A copy of Bankruptcy Judge Hayes' Findings of Fact and Recommendation is attached hereto, marked Exhibit "3" and made a part hereof.

9. Previously, and by order to show cause dated June 16, 1975, Mr. Raichle, as Trustee, petitioned the Reorganization Court for an order substantively consolidating the assets and liabilities of Homex and its subsidiary debtor corporations. That petition was opposed by the banks. Recital I of the Settlement Agreement described the desire of Mr. Raichle, as Trustee, and each and all of the banks to compromise and settle the dispute with respect to the banks' claims, "... and based upon such compromise and settlement, to cooperate so as to effect the substantive consolidation sought by the Trustee" Following the filing of Bankruptcy Judge Hayes' Findings of Fact and Recommendation, United States District Judge Harold P. Burke made

an order dated May 20, 1976 fixing (i) a hearing on June 14, 1976 on Mr. Raichle's application for an order confirming the Findings of Fact and Recommendation of Bankruptcy Judge Hayes, and (ii) June 14, 1976 as the time and place for a rehearing upon the Trustee's application to substantively consolidate the assets and liabilities of Homex and its debtor subsidiaries. Judge Burke's order of May 20, 1976 directed that notice of the hearings to be held on June 14, 1976 be given by mail to, among others, all parties who appeared before (i) Bankruptcy Judge Hayes at the hearing with respect to the Settlement Agreement on May 10, 1976, and (ii) the Reorganization Court on July 28, 1975, the date of the initial hearing upon the Trustee's application for substantive consolidation, as well as to all parties who had filed written notices of opposition to such application. A copy of Judge Burke's May 20, 1976 order is attached hereto, marked Exhibit "4" and made a part hereof.

10. The June 14, 1976 hearings were duly adjourned to June 28, 1976. On June 28, 1976, no opposition was asserted either to the Trustee's petition to compromise his objections to the claims of the banks or to the substantive consolidation, and by two orders dated and entered on June 29, 1976, Judge Burke confirmed the report of Bankruptcy Judge Hayes and authorized the settlement and directed substantive consolidation. Copies of those orders are attached hereto, marked Exhibits "5" and "6" respectively, and made a part hereof.

11. On December 21, 1976, Robert B. Block, Esq. of the New York City law firm of Pomerantz Levy Haudek & Block, representing preferred and common shareholders of Homex who had commenced a class action prior to July 12, 1972 against Homex, various

directors and officers thereof, accounting firms, and brokerage houses, which was pending in the United States District Court for the Southern District of New York, wrote to the Reorganization Trustee. A copy of his letter is attached hereto, marked Exhibit "7" and made a part hereof. In that letter, Mr. Block noted that the settlement between Mr. Raichle, as Trustee, and the banks would produce a distributable estate for general unsecured creditors, noted that Mr. Raichle intended to file a plan of reorganization in the nature of a liquidation and requested Mr. Raichle to solicit so-called fraud claims by present and former purchasers of securities of Homex.

12. As this Court will note, the Settlement Agreement between Mr. Raichle, as Trustee, and the banks provided that in consideration of a payment of \$7,000,000 by the Trustee to the banks, the banks would release all liens upon their collateral and agree to become general unsecured creditors of the Consolidated Debtor in the amounts set forth on Schedules III and IV attached to the Settlement Agreement, and would consent to the substantive consolidation sought by the Trustee.

13. On June 13, 1977, a hearing was held before the Reorganization Court on the application of the Trustee (to which was attached a copy of his report pursuant to Section 167(1) of Chapter X of the Bankruptcy Act) for a determination that the Consolidated Debtor be adjudged insolvent and that shareholders, as such, not vote on any plan of reorganization which might be adopted or participate in any distribution thereunder. A hearing was also scheduled on the same date for a judicial determination whether stockholders who previously filed proofs of claim based on fraud or other securities law violations, should be included as

general creditors for the purpose of participation in any distribution under any plan to be adopted. At the second hearing, Mr. Raichle expanded its scope to include all prior, as well as present, stockholders of Homex and took the position that the second hearing should be considered as a hearing under Section 197 of Chapter X of the Bankruptcy Act, to fix the division of creditors and stockholders into classes according to the nature of their respective claims and stock, for the purpose of any plan and its acceptance. Testimony was taken with respect thereto and the Reorganization Court determined that the Consolidated Debtor was insolvent (Transcript of Proceeding held June 13, 1977, p. 17). With respect to the expanded second hearing, Mr. Block of the Pomerantz firm appeared and filed an Attorney's Statement Under Bankruptcy Rule (Chapter X Rule) 10-211 (a), a copy of which is attached hereto, marked Exhibit "8" and made a part hereof. The Attorney's Statement filed by Mr. Block recited that his firm represented the following "stockholder-creditors ... Gregory Jezarian and Geraldine Jezarian ... and Lonetown Company" It appeared that each of the Jezarians and Lonetown Company was a stockholder of Homex at the time the Chapter X petition was filed on July 12, 1972 and at the present, and it must conclusively be presumed that they received copies by mail of the Bar Order dated December 11, 1972 (Exh. 1). The Attorney's Statement filed by Mr. Block recited that his representation of the Jezarians and Lonetown Company arose out of the retention of his firm by those persons to prosecute claims for Securities Acts violations against Homex and others, and pursuant to that retainer, an action entitled "Jezarian, et al v. Csapo, et al," had been brought and was pending in the United States District Court for the Southern District of New York, 72 Civ. 1671 (DBB).

Finally, Mr. Block recited that he appeared in the reorganization proceeding

"... not only for the above mentioned persons but for the class they represent as duly certified in Jezarian v. Csapo, to wit, purchasers of securities of Stirling Homex Corporation between March 16, 1971 and July 10, 1972."
(Underscoring ours)

A copy of the Consolidated Amended and Supplemental Complaint in the Jezarian class action, which encompasses two other class actions commenced against officers and directors of the Debtor and other parties, is attached hereto, marked Exhibit "9" and made a part hereof. One of the consolidated class actions involves an action instituted in 1974 by H. E. Jones and Aleck Goldberg, as Custodian for Mark Goldberg, on behalf of themselves and all others similarly situated. Reference should be made to the Trustee's Section 167 Report, page 19, for a description of the proof of claim filed by Harry E. Jones and Aleck Goldberg, as Custodian for Mark Goldberg, on behalf of themselves and all other persons similarly situated in the amount of \$30,000,000. The class action status of that claim was dismissed by an order of Judge Burke dated July 24, 1975. The claim of Mr. Jones, in the amount of \$3,968, and Mr. Goldberg, as Custodian, in the amount of \$2,594.63, remain open.

14. I. Walton Bader, Esq., another attorney, appeared and filed a Statement Under Bankruptcy Rule [sic] 10-211, a copy of which is attached hereto, marked Exhibit "10" and made a part hereof. That statement recited that Mr. Bader represented a holder of 100 shares of \$2.40 preferred stock of Homex, Mrs. D. Windsor Dixon, and that Mrs. Dixon "intends to represent a Class of stockholders of the debtor." Mr. Bader also filed a "Notice

of Appearance," a copy of which is attached hereto, marked Exhibit "11" and made a part hereof, which recited that Mrs. Dixon took the position that

"In her own behalf, and in behalf of the Class of stockholders of the debtor, that the said stockholders of the debtor are 'defrauded stockholders' and, as such, are entitled to participate in the assets of this Estate as 'General Creditors.'"

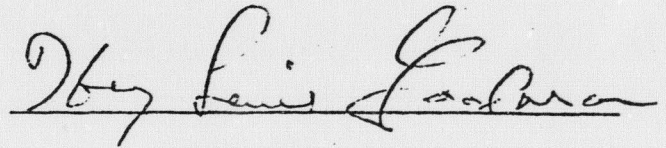
Mr. Bader also handed out a proposed Summons, Notice of Trial and "Complaint in Adversary Proceedings," seeking a judgment that the Reorganization Court declare that stockholders of the Debtor were defrauded stockholders and entitled to participate in any dividends to be declared in the proceeding as general creditors, and that the Court direct the Trustee to send to each member of the Class a proof of claim and that each stockholder be permitted to file a proof of claim as a defrauded stockholder within a time to be fixed by the Court. While it appears that this so-called adversary proceeding has not been commenced, copies of the aforementioned Summons and Notice of Trial and Complaint are attached hereto, marked Exhibit "12" and made a part hereof. It should be noted that Chapter X Rule 10-701, which defines adversary proceedings in Chapter X reorganizations, does not include the type of proceeding sought to be commenced by Mr. Bader as an adversary proceeding.

Presumably, Mr. Bader's client, Mrs. Dixon, who was a shareholder of Homex at the time of the filing of the petition on July 12, 1972, and at the present time, received a copy of the Bar Order (Exh. 1).

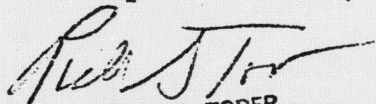
15. At the June 13, 1977 hearing to determine the insolvency of the Consolidated Debtor, an exhibit was received in

evidence as Trustee's Exhibit 3, bearing upon the estimated liquidation distributions to general unsecured creditors, whose audited claims aggregate \$45,961,000, excluding "shareholder creditors." A copy of Trustee's Exhibit 3 is attached hereto marked Exhibit "13" and made a part hereof.

16. At the June 13, 1977 hearing, Mr. Block informed the Court and counsel that the claims of "shareholder creditors" might aggregate \$100,000,000 (Transcript, p. 26).



Sworn to before me this
29th day of June, 1977



RICHARD S. TODAR
NOTARY PUBLIC, State of New York
No. 60-9349675
Qualified in Westchester County
Certificate filed in New York County
Commission Expires March 30 1978

**EXHIBITS TO THE FOREGOING AFFIDAVIT
REPRODUCED AS FOLLOWS:**

- Exhibit 1 —A24, *supra***
- Exhibit 2 —A52, *supra***
- Exhibit 3 —A108, *supra***
- Exhibit 4 —A115, *supra***
- Exhibit 5 —A142, *supra***
- Exhibit 6 —A146, *supra***
- Exhibit 7 —A412, *infra***
- Exhibit 8 —A189, *supra***
- Exhibit 9 —A417, *infra***
- Exhibit 10—A185, *supra***
- Exhibit 11—A187, *supra***
- Exhibit 12—Omitted from Appendix**
- Exhibit 13—A188, *supra***

POMERANTZ LEVY HAUDEK & BLOCK

ATTORNEYS AT LAW

A 412

ABRAHAM L. POMERANTZ
JULIUS LEVY
WILLIAM E. HAUDEK
ROBERT B. BLOCK
RICHARD M. MEYER
STANLEY M. GROSSMAN
DANIEL W. KRASNER
A. ARNOLD GERSHON
ROGER W. HAUDEK
STEPHEN P. HOFFMAN
ARTHUR JOSEPH

295 MADISON AVENUE
NEW YORK, N.Y. 10017
LEXINGTON 2-4000
CABLE ADDRESS "POMLAW" N.Y.

December 21, 1976

Frank G. Raichle, Esq.
Reorganization Trustee of Stirling
Homex Corporation
10 Lafayette Square
Buffalo, New York 14203

Re: Jezarian v. Csapo
U.S.D.C. S.D.N.Y.
72 Civ. 1671 (DBB)

Dear Mr. Raichle:

We are plaintiffs' attorneys in the captioned action which has been certified as a class suit for purchasers of securities of Stirling Homex Corporation between March 16, 1971 and July 10, 1972. The suit was commenced against Stirling Homex Corporation and others in advance of the bankruptcy. The present complaint, issued June 2, 1976, omits Stirling Homex Corporation as a defendant in deference to Judge Burke's stay of proceedings against the bankrupt, to which attention was recently called by affidavit of your counsel, Thomas W. Petrillo, filed in our action.

Until early this year it appeared that priority claims asserted by Stirling Homex's bank-creditors would exceed the amount of distributable assets, so that general creditors would take nothing. In consequence, however, of your advantageous sales of the bulk of the bankrupt's inventory of unsold modules and of your settlement with the banks, whereby they have accepted general creditor status, the estate now presents an altogether different picture: \$15 million to \$17 million for distribution on \$50 million of filed general creditors' claims.

EXHIBIT 7

Frank G. Raichle, Esq.
December 21, 1976
Page 2.

Meanwhile claims filed by members of the Jezarian class have been sparse - if not restricted to those of Harry E. Jones and Aleck Goldberg. (Their claims, insofar as purportedly filed for a class of defrauded shareholders, were disallowed on your motion by Judge Burke's memorandum-order of June 24, 1975.)

You have told us that the pending Chapter 10 proceeding is to culminate in conversion of the bankrupt's assets into cash and its pro-rata distribution among general creditors. Also that you do not contemplate calling for fraud claims by present and former buyers of Stirling Homex securities; and that you do not favor participation of such claims in the distribution to general creditors. This letter is an effort to persuade you to alter that view.

We urge that claims arising from the purchase of Stirling Homex common and preferred stock should be solicited for the following reasons:

1.

As you brought out so effectively on your § 167 examinations, a good part of the Company's recorded "sales" and "income" were fictitious. The most egregious single fraud, no doubt, was the Greater Gulf Coast "sale", backed by a forged financing commitment of the Farmers Home Administration. This fictitious transaction represented 23% to 45% of revenue in the Company's published earnings statements for the 7 months ended February 28, 1971, for the 9 months ended April 20, 1971 and for the 12 months ended July 31, 1971; and 23% to 29% of accounts receivable in the Company's published balance sheets as of the three dates just mentioned.

As against Stirling Homex, at least since April 21, 1971 when the Greater Gulf Coast "sale" was first reflected in published figures, materiality and scienter are plain; hence liability should be inescapable. Damages are easily determined as well because the Company's shares were as worthless when purchased as they were in terms of market value when the truth became known after bankruptcy. Accordingly, while the claims in question are "unliquidated", they can readily be proven without unduly delaying final distribution.

Frank G. Raichle, Esq.
December 21, 1976
Page 3

2.

Investors who have been swindled by a debtor into buying worthless securities suffer losses as real as those suffered by lenders, suppliers, sureties and other general creditors. There is no good reason to discriminate against the investors in this case; note that they include preferred stockholders who supplied \$20 million of fresh capital less than a year before the bankruptcy.

3.

Participation by defrauded security holders of the bankrupt, in plans for its reorganization, has of late been the rule rather than the exception: Westec Corp., S.D. Tex., No. 66-H-62; Four Seasons Nursing Centers of America, Inc., W.D. Okla., No. Bk-70-1008; Farrington Manufacturing Company, E.D. Va., No. 17-71-A; American Loan and Finance Company, E.D. Va. No. 508-72-N; Dolly Madison Industries, Inc., E.D. Pa., No. 70-354. It is understood that provision is also being made for defrauded security holders in the pending reorganization titled Equity Funding Corporation of America, C.D. Cal., No. 73-03467. In all the foregoing instances the issue was resolved by settlement rather than litigation; concededly, therefore, these are not rulings which mandate participation by defrauded security holders over a Trustee's objection. It has been held, however, that there is sufficient substance in such claims to justify a substantial settlement. In re Four Seasons Nursing Centers of America, Inc., 472 F.2d 747 (10 Cir. 1973); Associated Gas & Electric Co., 149 F.2d 996, 1009 (2 Cir.), cert. den. 326 U.S. 736 (1945).

4.

In our discussions you cited Matter of Cartridge Television Inc., 535 F.2d 1388, 1390-1 (2 Cir. 1976), as disfavoring participation by the Jezarian class as general creditors in the Stirling Homex liquidation. In our view the passage in Cartridge Television to which you have called attention is not controlling here for the reason that it rationalized, in a Chapter 11 proceeding, disallowance of

Frank G. Raichle, Esq.
December 21, 1976
Page 4

a security holder's fraud claim under Bankruptcy Act § 57(d). Section 57(d), which permits discretionary disallowance of unliquidated or contingent claims, has no application in Chapter 10. Rather, § 106 which defines "claims" to "include all claims of whatever character ..., whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent", is the governing provision. See 6 Collier on Bankruptcy, ¶ 2.05, pp. 311-12.

Note also the Supreme Court's decision in Oppenheimer v. Harriman National Bank & Trust Co., 301 U.S. 206, 215 (1937), a suit by a defrauded stockholder against an insolvent bank in liquidation. Plaintiff's judgment was held to rank with other unsecured creditors' claims. When a similar issue arose in Protective Committee v. Anderson, 390 U.S. 414, 453 (1968), a Chapter 10 case, the court did not depart from that ruling, explicitly leaving the question open. See also Tcherepin v. Knight, 389 U.S. 332, 346 (1967).

5.

We think it highly questionable that the Jezarian class has received adequate notice (a) to file proofs of claim, and (b) to object to the agreement with the banks.

The Order Fixing the Time and Manner of Filing and Allowing Proofs of Claim and of Stock Interests, in ¶ 1 thereof, excepted "proofs of claims of creditors ... founded on ... shares of stock ...". While the purpose of this language, no doubt, was to except claims for "Stockholder's interests" (see Order ¶ 7), the language might easily have been read, particularly by non-lawyers, as encompassing claims arising from the purchase of shares of stock. When the Order was entered, Jezarian and another suit were pending for the benefit of defrauded purchasers of Stirling Homex securities; and it would seem that plainer language might have been employed if the Order was meant as a call for claims based on Securities Laws violations.

Furthermore, it appears from Mr. Bonfiglio's affidavit of service of the Order that it was mailed only to stockholders "shown at the close of business December 29, 1972 on the record

Frank G. Raichle, Esq.
December 21, 1976
Page 5

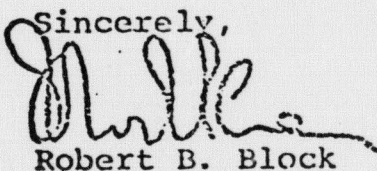
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of such holders maintained by said Chemical Bank." This was a mailing only to then current stockholders, and it omitted a large group of security fraud claimants who had purchased and sold their shares before December 29, 1972 and hence no longer appeared as holders of record on that date. The names and addresses of many of these former shareholders were available from the Company's earlier transfer records, and those persons should have been given notice as well. Mullane v. Central Hanover Bank and Trust Company, 334 U.S. 306 (1949); Schroeder v. City of New York, 371 U.S. 208 (1962).

A similar omission seems to have occurred with regard to the Order fixing the May 10, 1976 hearing of the Trustee's application for approval of his settlement with the banks. With regard to Stirling Homex security holders, that Order directed that it be mailed only to shareholders of record on December 31, 1973.

We are not anxious to relitigate the issue of the validity of a class proof of claim in bankruptcy. In our view, you should now call for individual claims by purchasers of Stirling Homex securities, based on Securities Laws violations. This, incidentally, was the procedure followed in the above cited Westec Corp. proceeding - concurrently with a Plan providing, among other things, for compromise of claims thereby solicited. We stand ready to discuss such a compromise with you, should you be disposed to consider it.

Sincerely,



Robert B. Block

RBB:ms

cc: Byron Johnson, Esq.
Johnson, Reif and Mullan, P.C.
47 South Fitzhugh Street
Rochester, New York 14614

-----X
GREGORY JEZARIAN, GERALDINE JEZARIAN,
and LONETOWN COMPANY,

PLAINTIFFS DEMAND
TRIAL BY JURY

Plaintiffs,

-against-

72 Civ. 1671 (DBB)

FRANK CSAPO, E. A. BARTZ, C. W. MARSHALL,
EDWIN J. SCHULZ, HARPER SIBLEY, JR.,
DAVID STIRLING, JR., WILLIAM G. STIRLING,
CARL L. WREN, PEAT, MARWICK, MITCHELL &
CO., MERRILL LYNCH, PIERCE, FENNER &
SMITH, INC. and CHEMICAL BANK,

Defendants.

-----X
H. E. JONES and ALECK GOLDBERG, as
Custodian for Mark Goldberg, on behalf of
themselves and all others similarly
situated,

Plaintiffs,

-against-

74 Civ. 61 (DBB)

DAVID STIRLING, JR., WILLIAM G. STIRLING,
HAROLD M. YANOWITCH, RICHARD E. KARKOW,
HARPER SIBLEY, JR., THEODORE KHEEL,
JOHN W. CASTELLUCCI, ESTATE OF DAVID
STIRLING, SR., C. W. MARSHALL, MERRILL
LYNCH, PIERCE, FENNER & SMITH, INC.,
HARRIS, KERR, FORSTER & CO., PEAT,
MARWICK, MITCHELL & CO., FRANK CSAPO,

Defendants.

-----X
DANIEL C. AGUIRRE,

Plaintiff,

-against-

72 Civ. 4744 (DBB)

MERRILL LYNCH, PIERCE, FENNER & SMITH,
INC., PEAT, MARWICK, MITCHELL & CO.,
DAVID STIRLING, JR., WILLIAM G. STIRLING,
PAUL M. KUYEKE, JR., H. M. YANOWITCH,
J. W. CASTELLUCCI, T. W. KHEEL, CHARLES
MARSHALL, E. A. BARTZ, FRANK CSAPO and
EDWIN J. SCHULZ,

Defendants.

-----X
CONSOLIDATED AMENDED AND SUPPLEMENTAL
COMPLAINT

Plaintiffs, complaining of defendants, allege upon information and belief, except as to ¶¶ 9-13 inclusive and 50 which each plaintiff alleges upon knowledge insofar as such allegations refer to him or her:

1st COUNT BY ALL PLAINTIFFS AGAINST
ALL DEFENDANTS EXCEPT CHEMICAL BANK

1. (a) The jurisdiction of the Court is based on § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, as amended, and the principles of pendent jurisdiction.

(b) The claims alleged herein arise under the Securities Exchange Act and in particular § 10(b) thereof; the rules and regulations of the Securities and Exchange Commission promulgated thereunder; and common law principles.

(c) The illegal acts complained of herein occurred in substantial part in the Southern District of New York.

2. Class Action Allegations

(a) A class action is alleged pursuant to Rule 23(b) (3), F. R. Civ. P.

(b) The class consists of all persons who suffered injury in their purchases of securities of Stirling Homex Corporation (the "Corporation") between October 7, 1970 and July 10, 1972. During this time the Corporation had approximately 8,900,000 shares of common stock outstanding. Additionally, the Corporation had, since July 29, 1971, 500,000 shares of \$2.40 convertible preferred stock outstanding. The Corporation's common stock and preferred stock have been widely held by many thousands of shareholders throughout the country.

The class consists of many thousands of such persons who were damaged by the misconduct hereinafter complained of.

(c) Plaintiffs are members of said class; their claims are typical of the claims of all class members. They and their counsel will fairly and adequately protect the interests of the class.

(d) The questions of law and fact common to the class include: The duty owed by defendants to members of the class; the materiality of the alleged misrepresented or undisclosed information; defendants' resulting liabilities; the measure of damages.

(e) The questions of law and fact common to the members of the class predominate over any questions affecting individual members.

(f) A class action is superior to other available methods for the fair and efficient adjudication of the controversy.

3. (a) The Corporation, a Delaware corporation, was adjudicated a bankrupt on July 13, 1972, in proceedings under Chapter 10 of the Bankruptcy Act in the United States District Court for the Western District of New York. In obedience to injunctive provisions of an order therein, the Corporation, joined as a defendant in Jezarian v. Csapo (brought before the bankruptcy), has since been eliminated as a defendant.

(b) The Corporation was engaged in the business of manufacturing, selling and installing modular dwelling units, mostly for publicly funded housing projects.

4. The individual defendants were directors or officers, or both, of the Corporation as indicated below:

(a) Defendant Bartz was a vice president and secretary on October 7, 1970 and until at least July 10, 1972.

(b) Defendant Csapo was a vice president on October 7, 1970 and until at least July 10, 1972.

(c) Defendant Marshall was a director from February 5, 1971 until at least July 10, 1972. He also was president of U. S. Shelter Corporation, a wholly owned subsidiary of the Corporation, from October 7, 1970 until at least July 10, 1972.

(d) Defendant Schulz was a vice president and controller on October 7, 1970 and until August 19, 1971, and senior vice president from that date until on or about March 1, 1972.

(e) Defendant Sibley was a director on October 7, 1970 and until February 5, 1971.

(f) Defendant David Stirling, Jr. was chairman of the board of directors and chief executive officer on October 7, 1970 and until July 10, 1972, except that he ceased to be chief executive officer on June 15, 1972.

(g) Defendant William G. Stirling was a director and president on October 7, 1970 and until July 10, 1972, except that he ceased to be president on May 3, 1972.

(h) Defendant Wren was director of market research on October 7, 1970 and until January 12, 1971 and a vice president from that date until on or about July 10, 1972.

(i) Defendant Yanowitch was a director and executive vice president and general counsel on October 7, 1970 and until July 10, 1972.

(j) Defendant Kheel was a director on October 7, 1970 and until at least July 10, 1971.

(k) Defendant Castellucci was a director on October 7, 1970 and until at least July 10, 1972.

(l) Defendant David Stirling, Sr. was a director and a vice president on October 7, 1970 and until on or about January 1, 1972.

(m) Defendant Kuveke was an assistant vice president on October 7, 1970 and until February 5, 1971, an assistant vice president and assistant treasurer from that date until June 11, 1971, treasurer from that date until August 19, 1971, vice president and treasurer from that date until May 3, 1972, and a director and president from that date until at least July 10, 1972.

(n) Defendant Karkow was a director, a vice president and treasurer on October 7, 1970 and until February 26, 1971.

5. Defendant Harris, Kerr, Forster & Co. ("Harris Kerr"), a partnership, was and is a firm of certified public accountants with offices in the Southern District of New York. From prior to October 7, 1970 until on or about February 24, 1971, Harris Kerr acted as the Corporation's independent certified public accountants and auditors; advised on and reviewed the Corporation's accounting methods and its interim financial statements; and certified the Corporation's financial statements for the fiscal year ended July 31, 1970. Harris Kerr participated as experts in the Corporation's registration statement and prospectus which became effective July 29, 1971, with regard to, among other financial statements of the Corporation, its financial statements for the fiscal year ended July 31, 1970.

6. Defendant Peat, Marwick, Mitchell & Co. ("Peat Marwick"), a partnership, was and is a firm of certified public accountants with offices in the Southern District of New York. From on or about February 24, 1971 until the Corporation became a bankrupt, Peat Marwick acted as the Corporation's independent certified public accountants and auditors; advised on and reviewed the Corporation's accounting methods and its interim financial statements; certified the Corporation's financial statements for the seven months ended February 28, 1971 and for the fiscal year ended July 31, 1971; and participated as experts in the Corporation's registration statement and prospectus which became effective on July 29, 1971 with regard to, among other financial statements of the Corporation, its financial statements for the seven months ended February 28, 1971.

7. Defendant Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") was and is a Delaware corporation with its executive offices in the Southern District of New York. Merrill Lynch was and is a leading investment banker and broker-dealer in corporate securities. From on or about January 20, 1971 until the Corporation's bankruptcy, Merrill Lynch served as the Corporation's investment banker. During most of that period Merrill Lynch was the principal market maker in the Corporation's securities.

8. On or about July 29, 1971, the Corporation issued 500,000 shares of its \$2.40 cumulative convertible preferred stock pursuant to the aforementioned registration statement and prospectus which became effective on that date. An underwriting group, led by Merrill Lynch, bought the entire issue and resold it to the public at the price of \$40 per share, a total price for

the issue of \$20 million.

9. Plaintiff Gregory Jezarian purchased 25 shares of the Corporation's common stock on March 19, 1971; plaintiffs Gregory Jezarian and Geraldine Jezarian purchased 50 shares of the Corporation's common stock on March 22, 1971; and plaintiff Gregory Jezarian purchased 100 shares of the Corporation's common stock on March 23, 1972.

10. Plaintiff Lonetown Company purchased 100 shares of the Corporation's preferred stock on January 6, 1972.

11. Plaintiff Jones purchased 200 shares of the Corporation's common stock on October 1, 1971.

12. Plaintiff Goldberg purchased 50 shares of the Corporation's preferred stock, as custodian for Mark Goldberg under the Pennsylvania Uniform Gift to Minors Act, on October 5, 1971.

13. Plaintiff Aguirre purchased shares of the Corporation's common stock as follows:

<u>No. of Shares</u>	<u>Date of Purchase</u>
500	April 6, 1972
300	April 13, 1972
200	June 14, 1972
200	June 28, 1972

14. During the period from October 7, 1970 through July 10, 1972 the Corporation materially and consistently overstated its income and net worth in its financial statements by reflecting purported sales of modules and purported revenues and receivables therefrom although sales had not been effected as a matter of law or of sound accounting principles and although such revenues and receivables had neither been billed nor were they

billable. Such purported sales and such unbilled and unbillable revenues and receivables totalled many millions of dollars and represented a major part of the Corporation's sales, revenues and receivables during the period. A large portion of the purported revenues and receivables so reflected in the Corporation's financial statements was never collected.

15. More specifically:

(a) In the Corporation's financial statements for the fiscal year ended July 31, 1970, which were certified by Harris Kerr, sales of modules and resulting revenues and receivables totalling at least \$10,350,000, involving ten housing projects, were recognized with the concurrence of Harris Kerr although it knew that the requirements for such recognition were not met.

(b) In the Corporation's financial statements for later periods, which were certified or reviewed by Peat Marwick, sales of modules and resulting revenues and receivables totalling at least \$33,250,000, involving eleven housing projects, were recognized with the concurrence of Peat Marwick although it knew that the requirements for such recognition were not met. No part of such \$33,250,000 of revenues and receivables was ever collected by the Corporation.

16. The Corporation's sales, revenues and receivables were invariably overstated by reason of the improper accounting alleged in ¶ 14 hereof, in, among other things, the following reports, preliminary prospectus, prospectus, press releases and letters to stockholders:

(a) A press release issued on or about October 7, 1970 which included a financial report for the fiscal year ended

July 31, 1970.

(b) The 1970 annual report to stockholders issued on or about October 16, 1970 which included financial statements for the fiscal year ended July 31, 1970.

(c) A form 10-K report filed on or about November 30, 1970 which contained financial statements for the fiscal year ended July 31, 1970.

(d) A form 10-Q report filed on or about March 16, 1971 which contained financial statements for the six months ended January 31, 1971.

(e) A press release issued on or about March 17, 1971 which included financial reports for periods ended January 31, 1971.

(f) A preliminary prospectus dated April 21, 1971 which included financial statements for the seven months ended February 28, 1971.

(g) A press release issued on or about May 20, 1971 which included financial reports for periods ended April 30, 1971.

(h) A form 10-Q report filed on or about June 17, 1971 which contained financial statements for the nine months ended April 30, 1971.

(i) The registration statement and prospectus which became effective July 29, 1971 and included financial statements for the fiscal year ended July 31, 1970, financial statements for the seven months ended February 28, 1971, and financial statements for the nine months ended April 30, 1971.

(j) A press release issued on or about September 15, 1971 which included a financial report for the fiscal year ended July 31, 1971.

(k) The 1971 annual report to stockholders issued on or about October 12, 1971 which included financial statements for the fiscal years ended July 31, 1970 and July 31, 1971.

(l) A form 10-K report filed on or about October 27, 1971 which contained financial statements for the fiscal years ended July 31, 1970 and July 31, 1971.

(m) A press release issued on or about December 7, 1971 which included a financial report for the three months ended October 31, 1971.

(n) A form 10-Q report filed on or about December 15, 1971 which contained financial statements for the three months ended October 31, 1971.

(o) A form 10-Q report filed on or about March 16, 1972 which contained financial statements for the six months ended January 31, 1972.

(p) A press release issued on or about March 17, 1972 which included financial reports for periods ended January 31, 1972.

(q) A press release issued on or about June 14, 1972 which included financial reports for periods ended April 30, 1972.

(r) A form 10-Q report filed on or about June 14, 1972 which contained financial statements for the nine months ended April 30, 1972.

(s) Letters to stockholders dated March 20, 1972 and May 10, 1972 which referred to results of operations for the six months ended January 31, 1972.

17. The reports, releases, preliminary prospectus, prospectus and letters listed in ¶ 16 hereof materially and

additionally overstated the Corporation's income or net worth by, among other ways:

(a) Failing to set up adequate reserves and provisions for doubtful accounts and losses.

(b) Improperly including installation work in sales and receivables on the percentage of completion method and, in connection therewith, arbitrarily allocating purported contract prices between modular units and installation work.

(c) Improperly treating unrecoverable excess costs as accounts receivable.

(d) Deferring rather than expensing research and development and project and production startup costs and similar outlays.

(e) Crediting a subsidiary, U. S. Shelter Corporation, with \$490,029 of income supposedly representing fees earned under agreements with non-affiliated customers although no such fees or income had in fact been earned.

18. The registration statement and the prospectus which became effective on July 29, 1971 were materially false in the following additional respects, among others:

(a) The Corporation's backlog was grossly overstated by including purported firm orders for the Corporation's products when in fact no such firm orders from financially responsible persons had been received.

(b) The Corporation's critical shortage of working capital and its difficult cash bind were concealed.

(c) The Corporation's construction of a plant in Gulfport, Mississippi, to manufacture townhouse, apartment and high-rise modules, was misrepresented as expected to commence in September 1971.

(d) U. S. Shelter Corporation was stated to have obtained an unsecured \$15,000,000 line of credit from a bank when in fact no such line of credit had been obtained or was obtainable.

19. The replacement of Harris Kerr by Peat Marwick as the Corporation's independent certified public accountants and auditors came about in this manner: For some weeks prior to February 24, 1971 defendants David Stirling, Jr., William G. Stirling and Yanowitch were anxious to improve the Corporation's forthcoming financial statements by including the entire amount of revenues and receivables attributable to a purported sale of a parcel of land for \$2,100,000, on which only a small down payment had been made to the Corporation. This transaction did not qualify as a sale for accounting purposes because of uncertainty as to collection of the balance of the sale price, and no revenues or receivables should have been recognized; instead the transaction should have been treated as a purchase option. Harris Kerr, the Corporation's then accountants and auditors, were reluctant to concur in recognition of the transaction as a sale. Peat Marwick was thereupon consulted; it shortly approved the transaction as a \$2,100,000 sale despite Harris Kerr's unwillingness to allow it. Peat Marwick was thereupon engaged in place of Harris Kerr as the Corporation's independent certified public accountants and auditors.

20. The Securities and Exchange Commission later disapproved of accounting for the transaction as a sale. At the insistence of the Commission the transaction was correctly reflected as a mere purchase option in the Corporation's pertinent financial statements contained in its registration statement and prospectus which became effective on July 29, 1971. Before the

Corporation changed its method of accounting for the transaction, however, the full amount of revenues and receivables purporting to derive therefrom were improperly included in the financial reports of the Corporation for the periods ended January 31, 1971, February 28, 1971 and April 30, 1971, as contained in the press releases, form 10-Q reports and the preliminary prospectus listed in ¶ 16 (d)-(h) hereof.

21. The Corporation sent the reports, releases and letters listed in ¶ 16 hereof to its securities holders and to the press, brokers and dealers, research organizations and financial institutions.

22. On or about April 21, 1971 Merrill Lynch distributed numerous copies of the Corporation's aforementioned preliminary prospectus to its many branch offices and within the financial community generally. Merrill Lynch similarly distributed the aforementioned prospectus which became effective on July 29, 1971. After that date until July 10, 1972 Merrill Lynch prepared and made available to its numerous salesmen, through its computerized wire system, a series of research reports, and condensed versions thereof known as QRQs, containing information and recommendations for the guidance of customers with regard to the Corporation's securities and the purported basis therefor. Merrill Lynch also widely distributed to its customers and others a favorable article on the Corporation in a Merrill Lynch house publication called Investors Reader.

23. The research reports and Investors Reader article were materially false and misleading in that, among other things, they failed to disclose that the Corporation's sales, earnings and financial position were overstated and its reserves and liabilities understated in the respects alleged in ¶¶ 14 and

17 hereof; that it was unlikely that an additional plant, described as projected for early completion in Mississippi, could be financed and constructed; that the Corporation was in a critical cash bind and running out of bank credit; that the aforementioned prospectus misrepresented that U. S. Shelter Corporation had a \$15,000,000 unsecured line of bank credit; that the Corporation's backlog was grossly overstated; and that the Corporation's accounting practices and hence its prior financial reports and statements, including those contained in the aforementioned preliminary prospectus and prospectus, were unsound and grossly misleading.

24. The figures and writings hereinabove referred to were disseminated in interstate commerce and by the use of the mails and were false and misleading in that they contained untrue statements of material facts and omitted to state material facts necessary in order to make the statements made in light of the circumstances in which they were made not misleading.

25. Defendants either knew of the falsity of the aforementioned figures and writings; or else defendants were recklessly indifferent to whether such writings were true or false and, if false, to their propensity to deceive the investing public, and closed their eyes to, among other things, obvious infirmities in the Corporation's purported sales, receivables and backlog. At the least, defendants were grossly negligent in issuing or certifying or reviewing or approving or acquiescing in such false figures and writings, as the case may have been.

26. The Corporation's shares were actively traded in the over-the-counter market. As a result of the dissemination of the aforementioned false figures and writings, the market prices of the Corporation's securities were artificially and

continuously inflated during the period between October 7, 1970 and July 10, 1972. In ignorance of the falsity of such figures and writings, plaintiffs and other members of the class relied on the integrity of the market prices during said period in purchasing their shares.

27. The individual defendants controlled the Corporation and are jointly and severally liable for its wrongdoings pursuant to § 20 of the Securities Exchange Act, 15 U.S.C. § 78t.

28. Plaintiffs and members of the class have suffered substantial injury as a result of the wrongs herein complained of.

2nd COUNT BY PLAINTIFF LONETOWN COMPANY
AGAINST DEFENDANTS MARSHALL, DAVID
STIRLING, JR., WILLIAM G. STIRLING, PEAT
MARWICK AND MERRILL LYNCH

29. (a) The jurisdiction of the Court is based on § 22 of the Securities Act of 1933, 15 U.S.C. § 77v, as amended.

(b) The claims alleged herein arise under § 11 of the Securities Act, 15 U.S.C. § 77k.

30. Class Action Allegations

(a) A class action is alleged pursuant to Rule 23(b)(3), F. R. Civ. P.

(b) The class consists of all persons who bought preferred stock of the Corporation before July 11, 1972. The class consists of thousands of such persons who were damaged by reason of the material falsity of the registration statement and prospectus which became effective on July 29, 1971 as hereinafter alleged.

(c) Plaintiff is a member of said class; its claims are typical of the claims of all class members. Plaintiff and its counsel will fairly and adequately protect the interests of the class.

(d) The questions of law and fact common to the class include: Whether and in what respects the registration statement and prospectus were materially false; the liability of the defendants therefor; the measure of damages.

(e) The questions of law and fact common to the members of the class predominate over any questions affecting individual members.

(f) A class action is superior to other available methods for the fair and efficient adjudication of the controversy.

31. Plaintiff realleges ¶¶ 3, 4(c), 4(f), 4(g), 6, 7, 8, 10, 14, 15, 16(i), 17 and 18 hereof.

3rd COUNT BY PLAINTIFF LONETOWN
COMPANY AGAINST DEFENDANTS CHEMICAL
BANK, MARSHALL AND MERRILL LYNCH

32. (a) The jurisdiction of the Court is based on § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, as amended, and the principles of pendent jurisdiction.

(b) The claim alleged herein arises under the Securities Exchange Act and in particular § 10(b) thereof; the rules and regulations of the Securities and Exchange Commission promulgated thereunder; and common law principles.

(c) The illegal acts complained of herein occurred in substantial part in the Southern District of New York.

33. Plaintiff realleges ¶¶ 2, 3, 4(c), 7, 8 and 10 hereof.

34. Defendant Chemical Bank is a banking corporation created and existing under the laws of the State of New York with offices for the conduct of business in the Southern District of New York.

35. In March 1971, defendant Chemical Bank was the Corporation's leading banker; the Corporation was heavily indebted to defendant Chemical Bank on an unsecured basis; and defendant Chemical Bank was anxious that the Corporation's contemplated public offering of equity securities succeed, as that would improve the position of defendant Chemical Bank as a creditor of the Corporation.

36. Before March 23, 1971 defendants named in Count 1 hereof, particularly Merrill Lynch, concluded that the forthcoming prospectus should indicate that U. S. Shelter Corporation ("Shelter"), a wholly owned subsidiary of the Corporation, had banking support and proper financing. Merrill Lynch requested that Shelter procure a letter from a bank purporting to fulfill that requirement.

37. Defendant Marshall, then president of Shelter (as well as a director of the Corporation) and a retired banker who was well acquainted with senior officers at defendant Chemical Bank, undertook to obtain a letter from defendant Chemical Bank to comply with Merrill Lynch's request.

38. On March 23, 1971 defendant Marshall met with a group of officers of defendant Chemical Bank at its head office in New York City and requested a letter from defendant Chemical Bank indicating its support of Shelter. Defendant Marshall explained that the Corporation would shortly be making a public offering of equity securities and that the underwriter, Merrill

Lynch, had requested that the Corporation obtain a letter from a bank so that the prospectus could indicate that Shelter had proper financing.

39. Defendant Chemical Bank immediately complied with defendant Marshall's request, issuing the desired letter the very next day, March 24, 1971. The letter was reissued, with minor changes requested by the Corporation, under date of March 29, 1971. Both versions of the letter were artfully cast so as to allude at the outset to a \$15,000,000 line of credit while at the same time limiting advances thereunder to \$3,000,000 outstanding at any one time and so as to avoid committing defendant Chemical Bank in any amount at all. In fact no line of credit, under the internal procedures consistently followed by defendant Chemical Bank in establishing lines of credit for borrowing customers (including, on other occasions, the Corporation and Shelter), was established following the issuance of these letters. No credit was ever extended and no advance was ever made to Shelter under these letters.

40. On the strength of the letters described in ¶ 39 hereof, the registration statement and prospectus referred to in ¶ 8 hereof was caused and permitted to become effective and to be issued with the inclusion of the following materially false and fraudulent representations, at page 34 of the prospectus:

(a) A note to the balance sheet for Shelter reading: "The subsidiary [i. e., Shelter] has obtained an unsecured \$15,000,000 line of credit from a bank. These funds are being used in financing transactions involving customers of the Company. The Company [i. e., the Corporation] has not guaranteed this line of credit."

(b) Inclusion of \$300,000 of "Finance income" in Shelter's income statement, subjoined to its balance sheet.

The section of the prospectus presenting Shelter's aforementioned financial statements was referred to at page 13 of the textual portion of the prospectus, in a passage dealing with the financing of the Corporation's business. In fact (a) Shelter had no line of credit, and no assets of any consequence, and no financing capability whatever; and (b) Shelter had no such "finance income" (or any income) and was incapable of earning any "Finance income" (but purportedly was in a position to accrue financing fees through the claimed existence of the described \$15,000,000 line of bank credit in its favor).

41. By its conduct aforementioned defendant Chemical Bank aided and abetted, and conspired with defendants Marshall and Merrill Lynch among others in, the issuance of a materially false registration statement and prospectus and, accordingly, the commission of a fraud on plaintiff and members of the class who bought securities of the Corporation on and after July 29, 1971 when the aforementioned registration statement and prospectus became effective.

42. Plaintiff and members of the class have suffered substantial injury as a result of the wrongs herein complained of.

4th COUNT BY PLAINTIFF LONETOWN
COMPANY AGAINST DEFENDANT MERRILL
LYNCH

43. (a) The jurisdiction of the Court is based on § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, as amended, and the principles of pendent jurisdiction.

(b) The claim alleged herein arises under the Securities Exchange Act and in particular §§ 10(b) and 15(c) thereof; the rules and regulations of the Securities and Exchange Commission promulgated thereunder; and common law principles.

(c) The illegal acts complained of herein occurred in substantial part in the Southern District of New York.

44. Plaintiff realleges ¶ 2 hereof.

45. Defendant Merrill Lynch is, among other things, a broker and dealer in corporate securities. It is a Delaware corporation with its principal executive offices in the Southern District of New York.

46. Defendant commenced to make a market in the Corporation's common stock on January 12, 1971 and in the Corporation's preferred stock on or about July 29, 1971. Since those dates until at least July 10, 1972 defendant was the principal market maker for both such securities.

47. While defendant was making a market in the Corporation's securities, all or virtually all such securities which were bought by defendant's customers were bought from defendant acting as principal for its own account rather than from defendant acting as broker or agent for the account of others.

48. The profits gained by defendant in selling securities as principal normally were larger than commissions which the firm earned in selling comparable securities as broker.

49. The compensation which defendant's account executives or salesmen received or expected to receive from effecting sales of securities for defendant's account as principal

normally exceeded the compensation which such account executives or salesmen received for effecting brokerage transactions in comparable securities.

50. Plaintiff bought 100 shares of the Corporation's preferred stock from defendant acting as principal for its own account on January 6, 1972. Defendant did not disclose to plaintiff that there were special incentives for it and its account executives or salesmen to effect sales of the Corporation's securities.

51. No such disclosure was made to members of the class.

52. The special incentives for defendant and its account executives or salesmen to effect the sale of the Corporation's securities were material facts which should have been disclosed. Their nonrevelation was a scheme or artifice to defraud, entitling plaintiff and members of the class to rescind their purchases or to damages.

5th COUNT BY PLAINTIFFS GREGORY
JEZARIAN, TONETOWN COMPANY, JONES,
GOLDBERG AND AGUIRRE AGAINST
DEFENDANTS CSA O, BARTE, MARSHALL,
SCHULZ, SIBLEY, DAVID STIRLING, JR.,
WILLIAM G. STIRLING AND WREN

53. Plaintiffs reallege §§ 1, 2, 3, 4(a)-(h) and 5-28 inclusive hereof.

54. For the three months ended January 31, 1972 the Corporation reported a net loss before taxes of \$4,362,789, the first reported loss in the Corporation's history. This was a reflection of the auditors' refusal to concur in recognition of

certain of the dubious sales and income originally booked by the Corporation.

55. It was apparent to the individual defendants, by reason of their positions and relationships with the Corporation, at least as early as September 1971, that the Corporation could not for long continue reporting income on the strength of dubious or non-existent sales. Recurring reports of mounting losses were readily foreseeable by the individual defendants at least as early as September 1971.

56. Exploiting material non-public information acquired by them through their positions and relationships with the Corporation, defendants sold shares of the Corporation's common stock which they owned. During the period September 17, 1971 to June 15, 1972, defendant Sibley sold at least 350,000 shares; defendant David Stirling, Jr. sold at least 44,000 shares; defendant William G. Stirling sold at least 44,000 shares; defendant Bartz sold at least 8,000 shares; defendant Csapo sold at least 22,500 shares; defendant Marshall sold at least 10,000 shares; defendant Schulz sold at least 3,200 shares; and defendant Wren sold at least 17,000 shares.

57. The aforesaid 498,700 shares of the Corporation's common stock were sold by the individual defendants at an average price of approximately \$20 per share.

58. On March 20, 1972 the market price of the Corporation's common stock dropped sharply to approximately \$10 per share and shortly thereafter the market price went below \$6 per share. On and after July 11, 1972 when the Corporation filed in bankruptcy, its shares were essentially worthless.

59. Defendants are liable for damages to all class members who, while defendants were selling their common shares in the Corporation, purchased shares of the Corporation in the open market without knowledge of the material inside information which was in defendants' possession at that time.

WHEREFORE, plaintiffs pray for judgment:

(a) Awarding plaintiffs and all members of the class damages for the wrongs herein complained of or alternatively rescission or rescissory damages as may be equitable and appropriate.

(b) Awarding plaintiffs the costs and expenses of the litigation, including reasonable counsel and accounting fees; and

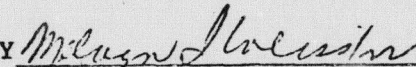
(c) Granting such other and further relief as may be just.

POMERANTZ LEVY HAUDEK & BLOCK

BY 

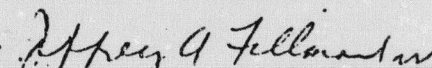
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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

A 440

In the Matter
of
STIRLING HOMEX CORPORATION,
Consolidated Debtor
(Classification of Claims)

IN PROCEEDINGS FOR
REORGANIZATION UNDER
CHAPTER X OF THE
BANKRUPTCY ACT

BK-72-1399

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Rochester, N.Y. 14614
Attorneys for Trustee

Brown, Kelly, Turner, Hassett & Leach
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Attorneys for Travelers Indemnity

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Attorneys for Lincoln First Bank of Rochester

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Attorneys for Merrill, Lynch, Pierce, Fenner
& Smith, Inc.

On the application of the Trustee in reorganization of Stirling Homex Corporation, consolidated debtor, this court by order dated April 28, 1977 fixed June 13, 1977 at 2:00 P.M. in the United States Court House, Rochester, New York, as the time and place of a hearing for a determination that the consolidated debtor be adjudicated insolvent and that the stockholders may not vote on any proposed plan of reorganization or participate in any distribution; and for a determination whether the stockholders who have heretofore filed proofs of claim based on fraud or other securities law violations shall be included as general creditors for the purpose of participation in any distribution under any adopted plan of reorganization.

A hearing was held on June 13, 1977 as directed. On the testimony of the Trustee and on the papers and reports filed, the consolidated debtor, Stirling Homex Corporation, has been found to be insolvent. The Trustee has reported that a reorganization of the debtor in the sense of floating

out of trusteeship a workable operating company is impossible; that the only fair and equitable plan which can be promulgated would be one of orderly liquidation of the debtor's assets and a distribution of the proceeds among its creditors. The Trustee moves for a judicial determination whether stockholders who have previously filed proofs of claim based on alleged fraud or other securities violations should share on an equal basis with general unsecured creditors in any distribution under any plan to be proposed.

At the hearing Robert B. Block of the firm of Pomerantz, Levy, Haudek & Block, attorneys for plaintiffs in a certified class action, Jezarian et al vs. Caspo et al, pending in the United States District Court for the Southern District of New York, 72 Civ. 1677, appeared for this class which includes thousands of stockholders of the debtor, past and present, arguing that the members of the class should share in any distribution. At the hearing there also appeared I. Walton Bader of the firm Bader & Bader, representing an additional class of preferred present stockholders of the debtor.

With the express consent of all parties present, and at the request of the Trustee, the hearing was broadened to include a determination of the claims of the allegedly defrauded stockholders, past and present, whether they had theretofore filed proofs of claim or not.

Section 197 of the Bankruptcy Act reads in part, "For the purposes of the plan and its acceptance, the judge shall fix the division of creditors and stockholders into classes according to the nature of their respective claims and stock."

Rule 10-302 of the Rules of Bankruptcy Procedure provides in part as follows: "(a) Classification of Claims: For the purposes of the plan and its acceptance, the court may fix, after hearing on such notice as it may direct, the division of creditors and stockholders into classes according to the nature of their respective claims and stock."

At the ^{hearing} ~~hearing~~, counsel for the certified class estimated that the claims of the members of the class would aggregate approximately One Hundred Million Dollars (TR 26) with an anticipated total of Fifteen Million or Sixteen Million Dollars to be distributed among all unsecured creditors. A determination of whether allegedly defrauded stockholders should share in the distribution on an equal basis with the Forty-six Million Dollars of claims of conventional general unsecured creditors should be determined before the formulation of a plan.

The plan for which the classification of claimants is sought is not a plan of reorganization in the sense of floating out of the Trustee a workable operating company. The consolidated debtor has been adjudicated insolvent.

The only fair and equitable plan is one which would provide for orderly liquidation of the debtor's assets and a distribution of the proceeds among its creditors.

The stockholders claims based on fraud or other violations of securities laws, are contingent and unliquidated. The contingent claimants are not now and may never be creditors of the consolidated debtor. A determination of the claims involves serious factual and legal issues. Substantial disputes may well be expected to arise in establishing the claims of any such alleged creditors, the application of limitation of actions and the measure of damages.

If the claims of alleged defrauded stockholders are not subordinated to the claims of conventional general unsecured creditors, a wholly new element will have been created in the financial structure of business. No longer will creditors, whether banks, suppliers, or subcontractors, be free as they now are to extend credit to the ordinary course of business on their presumed right to be accorded priority over the claims of investors and speculators in securities, without first obtaining a secured basis which will guarantee them a priority status in the event their customer defaults. Such a fundamental change in the financial structure of the business community is unwarranted in the absence of legislation designed to overturn the long established rule of absolute priority.

Where, as here, the debtor has been adjudicated insolvent, and the stockholders as such may not participate in distribution, the plan must be one of liquidation and distribution to the creditors. A determination is required as to whether the conventional general creditors and those creditors whose claims are grounded on fraud or securities law violations committed upon them as stockholders, shall share equally in distribution or whether the class of conventional creditors shall take precedence over the class of defrauded stockholder creditors. I find that it is fair and equitable that the class of conventional general creditors take precedence over the class of alleged defrauded stockholder claims.

Defrauded stockholder claimants in the purchase of stock are presumed to have been bargaining for equity type profits and assumed equity type risks. Conventional creditors are presumed to have dealt with the corporation with the reasonable expectation that they would have a senior position against its assets, to that of alleged stockholder claims based on fraud. They may be presumed to have bargained for debt type profits and certainty of payments.

On all the evidence it is hereby

ORDERED that, in the exercise of discretion, the claims of allegedly defrauded stockholders are classified as subordinate to the claims of conventional general creditors.



HAROLD P. BURKE
United States District Judge

July 27, 1977.

BY P.L.

A 447

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

In the matter of

STERLING HOMEX CORPORATION

Bankruptcy No.
BK-72-1399

Debtor

NOTICE OF APPEAL

NOTICE IS HEREBY GIVEN that MRS. D. WINDSOR DIXON, in her own behalf and in behalf of all other stockholders of STERLING HOMEX CORPORATION similarly situated, hereby appeal to the United States Court of Appeals for the Second Circuit from each and every part of an Order of HON. HAROLD P. BURKE, United States District Judge, said Order being made on July 27th, 1977 and thereafter entered in the office of the Clerk of the United States District Court for the Western District of New York, said Order holding that, in the exercise of discretion, the claims of defrauded stockholders are classified as subordinate to the claims of conventional general creditors, and this appeal is taken from said Order and from each and every part thereof.

Dated : August 12th, 1977

Yours, etc.

TO: CLERK OF UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT
OF NEW YORK

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and circumstanced
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A 448

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PHILLIPS, LYTLE, HITCHCOCK, BLAINE & HUBER, Esqs.
Attorneys for Marine Midland Bank
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SECURITIES AND EXCHANGE COMMISSION
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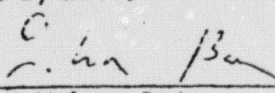
BROWN, WOOD, IVEY, MITCHELL & PETTY, Esqs.
Attorneys for Merrill, LYNCH, PIERCE, FENNER & SMITH, INC.
One Liberty Plaza
New York, N.Y. 10006

AFFIRMATION OF SERVICE

STATE OF NEW YORK
ss;
COUNTY OF NEW YORK

I, WALTON BADER, a member of the Bar of the State of New
York, hereby states under penalties of perjury that on August 13th,
1977 he served a copy of the foregoing Notice of Appeal upon each
of the attorneys set forth hereinabove by mail.

Dated : August 13th, 1977


I. Walton Bader

A 449

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

-----x
In the Matter of

STIRLING HOMEX CORPORATION,

Consolidated Debtor.

IN PROCEEDINGS FOR
REORGANIZATION UNDER
CHAPTER X OF THE
BANKRUPTCY ACTS.

BK - 72-1339
-----x

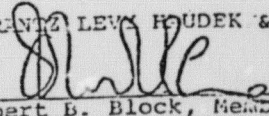
NOTICE OF APPEAL

NOTICE IS HEREBY GIVEN that Gregory Jezarian, Geraldine Jezarian and Lonetown Company, in their own behalf and in behalf of a class (or classes) they represent as certified in the action pending in the United States District Court for the Southern District of New York titled Jezarian, et al. v. Csapo, et al., 72 Civ. 1671 (DBB), to wit, purchasers of securities of Stirling Homex Corporation between March 16, 1971 and July 10, 1972, and Harry E. Jones and Aleck Goldberg, as custodian for Mark Goldberg, hereby appeal to the United States Court of Appeals for the Second Circuit from the Memorandum-Order herein dated July 27, 1977 and entered in this proceeding on July 28, 1977, which in the exercise of discretion classifies claims of allegedly defrauded stockholders as subordinate to the claims of conventional general creditors.

Dated: New York, New York
August 22, 1977

Yours, etc.

POMERANTZ LEVY HAUDEK & BLOCK

BY 

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CERTIFICATE OF SERVICE

I am over the age of 18 years and am in the employ
of Pomerantz Levy Haudek & Block.

On November 30, 1977 I served the annexed Joint
Appendix in behalf of appellants on all of the following
attorneys for appellees by delivering copies thereof
enclosed in sealed first-class post-paid envelopes to the
United States Postal Service in the post office maintained
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